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No.

In the Supreme Court of the United States

JOSEPH P. NACCHIO,

PETITIONER,

v.

UNITED STATES OF AMERICA,

RESPONDENT.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Joseph P. Nacchio, the former CEO of Qwest Communications, was convicted of insider trading for selling Qwest stock while knowing internal Qwest predictions and interim operating results allegedly placing Qwest at risk of missing its year-end 2001 public revenue projections eight to twelve months in the future. The Tenth Circuit panel and *en banc* opinions affirming that conviction conflict with holdings of other circuits and raise several questions meriting review.

1. Whether the defendant is entitled to acquittal or a new trial because the Tenth Circuit, in conflict with the standards applied in other circuits, erred by upholding the jury instructions bearing on the materiality of the type of information at issue, and by holding that there was sufficient evidence that the defendant failed to disclose material information and knew it.

2. Whether the judgment must be reversed and remanded for a new trial because the Tenth Circuit approved the use of impermissible procedures for the exclusion of expert testimony under Rule 702 that conflict with decisions of other circuits.

3. Whether the Tenth Circuit's decision should be summarily reversed because it misapplied decisions of this Court, mischaracterized the district court's reasoning, failed to resolve all the issues presented, and held that Nacchio failed to address an issue that was a principal focus of his brief.

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OPINIONS BELOW

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JURISDICTION

The Tenth Circuit's *en banc* opinion was issued on February 25, 2009. This Court has jurisdiction under 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The appendix reproduces the relevant statutes, regulations and rules.

INTRODUCTION

A sharply divided *en banc* Tenth Circuit recently reinstated the conviction of Joseph P. Nacchio, the former CEO of Qwest Communications, for insider trading. Nacchio built Qwest into a telecommunications giant but became a high-profile target after Qwest's stock collapsed amid the 2001 telecommunications meltdown and a subsequent accounting restatement. He was accosted on the streets, depicted by the Denver Post alongside North Korean dictator Kim Jong Il, and even the trial judge "s[aw] no reason why this man who grew up, the son of Italian immigrants ... in New Jersey and New York, should ever have come out here to Colorado." App.349a.

After five years of investigating, the prosecution evidently concluded that it could not prove any wrongdoing behind the restatement or the decline in Qwest's share price, and decided instead to prosecute

Nacchio for insider trading. The case merits review for several reasons.

First, this is the first time an executive has *ever* been charged with insider trading when the allegedly material "inside" information consisted of internal corporate risk assessments about financial results for future quarters. The Tenth Circuit agreed it was a "close question" whether that information was immaterial as a matter of law, but ultimately held that Nacchio could be sent to prison because a Qwest manager allegedly warned him in December 2000 or January 2001 of some "risk" that Qwest *might* fall short of its year-end 2001 projections by up to 4.2%, eleven or twelve months later, in a highly uncertain economic climate.

This Court recognized in *Basic Inc. v. Levinson*, 485 U.S. 224, 232 n.9 (1988), that special standards may be necessary for assessing the materiality of "contingent or speculative information, such as earnings forecasts or projections," but declined to resolve the issue. In the ensuing two decades the lower courts have fractured. In several other circuits, the allegations against Nacchio would have been dismissed as a matter of law even in a civil case. The proper standard is a matter of great national importance and merits review.

Second, the Tenth Circuit affirmed the jury instructions only by holding that uninformative instructions are not reversible unless they affirmatively misstate the law, and that a defendant forfeits any challenge unless his own proposed instructions are perfect. Those holdings squarely conflict with holdings of this Court and multiple other circuits.

Third, the prosecution convinced the court to exclude the heart of Nacchio's defense—the proposed expert testimony of Professor Daniel Fischel. Fischel is the former dean of the University of Chicago Law School, and the nation's leading expert in securities matters. He has testified more than 200 times (including for the government) and had never before been excluded. The government somehow convinced the district court that expert testimony on materiality and stock price movements is irrelevant or unnecessary in securities cases, and that Fischel should be excluded without *voir dire* or a *Daubert* hearing because Nacchio's pre-trial summary notice under Federal Rule of Criminal Procedure 16 did not establish the admissibility of the testimony under Rule 702. All of that was clear error, as the panel held when granting a new trial.

The government then abandoned its prior arguments and convinced the *en banc* court to affirm, on the new ground that Nacchio failed to justify Fischel's methodology under *Daubert* in response to the government's motion. That analysis conflicts with decisions of this Court and other circuits holding that expert testimony cannot be excluded without a hearing unless the existing record allows the court to evaluate the expert's methodology.

Finally, at a minimum summary reversal is warranted. As the *en banc* dissenters explained in detail, the majority mischaracterized the district court's decision, ignored settled law, and ducked meritorious issues to gloss over obviously prejudicial errors by a district judge whose "sense of fairness toward this defendant" was very much in doubt, App.92a (McConnell, J., dissenting), and who openly

displayed ethnic bias against the defendant and his counsel and recently resigned in disgrace in a lurid prostitution and obstruction of justice scandal.

STATEMENT OF THE CASE

Factual Background

1. Nacchio held 7.4 million $5.50 options expiring in June 2003. He did not want to sell and asked the board to extend the term. CAJA-1929-30.[1] For accounting reasons, the board could not. *Id.* To protect Qwest by spreading the sales over time, CAJA-1879, Nacchio announced in October 2000 that (so long as the price was reasonable, CAJA-2958) he would exercise and sell about a million options per quarter—but that he would not sell any of his vast holdings without a sunset problem, CAJA-1929. This announcement was months before the government alleges Nacchio received any material information. *E.g.*, CAJA-1392.

2. On September 7, 2000, Qwest raised its 2001 public revenue projections to $21.3-$21.7 billion. CAJA-4781. Qwest's business units then developed budgets designed to meet internal targets that were "set higher than the street numbers to encourage the employees to exceed the public values." CAJA-1918, 2138-39, 2373-77. The internal target was initially $22 billion, and later $21.8 billion. CAJA-2267, 2429-30.

Qwest had met or exceeded its public revenue targets for 17 straight quarters. CAJA-2259. Qwest's revenues came from "recurring" subscriber revenues (such as phone service) and sales of capacity on Qwest's fiber-optic network, known as indefeasible rights of use

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[1] "CAJA" refers to the joint appendix in the Tenth Circuit. "GX" refers to the government's trial exhibits.

or "IRUs."[2] Qwest's 2001 projections were initially based on growth in "recurring" revenues, CAJA-2177, 2600, and IRU sales.

3. In December 2000 or January 2001, the government's cooperating witness Robin Szeliga told Nacchio that when she "aggregated all the risk" in "the targets that had been assigned to the [business units]," she saw "a billion dollars of risk as it related to the target that we had set." App.229a-230a. The Tenth Circuit later held it was ambiguous whether Szeliga was talking about the $22 billion internal target (suggesting a possible $300 million, or 1.4%, shortfall from the $21.3 billion public projection) or instead was describing the contents of a memo, which Nacchio never saw, forecasting $1.2 billion in risk against a $21.6 billion baseline (a $900 million, or 4.2%, shortfall from the public projection). App.141a-43a.

Qwest's revenues met public expectations in the first and second quarters (during Nacchio's trades), and nearly equaled the internal targets. CAJA-2309-10. In April, although "recurring" revenue was off its internal target by 19%, App.277a, IRU sales in Grant Graham's global-business unit and Greg Casey's wholesale-markets unit were booming. Graham's first quarter sales were 61% *greater* than forecast, CAJA-5060; GX932, and by the end of the second quarter, these units achieved "non-recurring" revenues of $1.065 billion—98% of the company's *year-end* target. GX932; GX947.

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[2] This petition accepts the Tenth Circuit's phrasing, but IRU sales also "recurred" year-after-year, and historically dominated Qwest's revenues.

Because IRU sales were greater than projected but "recurring" revenue growth was disappointing, in early April Qwest's senior managers revised their projections. That "current estimate" or "Current View of 2001" projected that 2001 revenue would reach $21.56 billion, *comfortably above the low end of the public projection.* App.276a-77a. Graham, a cooperating witness for the government, testified that "[t]he representation of the [April 9] forecast" "provid[ed] our best belief of what things were going to happen." App.244a. Szeliga testified that Nacchio was told at this meeting that, as of April 9th, "*with all of the debates* ... the internal current view of Qwest was that they would reach $21.5 billion by December 31st, 2001." App.236a; CAJA-3276-77 (COO confirming same).

The only quantifiable "risk" presented to Nacchio was in Casey's wholesale-markets forecast, which identified $350 million of budget "risk" due to "slowed" "capital spending among Carriers" and Casey's predictions about the economy. App.278a, 241a-42a; CAJA-2228-29. Graham disagreed, and Casey had been wrong before—his unit's fourth-quarter 2000 revenues were $276 million or almost 35% greater than he projected. CAJA-4939-40, 5049. Even if Casey's "risk" were treated as certain, it suggested a 0.4% shortfall.

4. On April 24, 2001, Nacchio and Szeliga reaffirmed Qwest's public projections in a conference call with analysts. App.281a-96a. Nacchio disclosed, however, that he was "not pleased with the performance of [the consumer and small business] unit,"App.286a—known to the market as the main driver of "recurring" revenues—and that Qwest had to reduce its reliance on that sector for year-end revenue

projections. Although the Tenth Circuit later held that "[a] reasonable jury" could conclude that Nacchio knew "recurring revenue was off its target by 19%," and "that he acted upon this nonpublic information when deciding to trade," App.155a, on the April 24 call Nacchio *told the market* that although Qwest had projected growth of 8-9% in the consumer and small business sector, they had achieved only 6.3%—disclosing a 21% shortfall—and that "we are [now] going to be talking somewhere between 6 and 8 percent" for the year. App.294a-95a. (The prosecution's analyst witnesses understood that disclosure loud and clear. CAJA-3636, 4935.) Nacchio said there was "softness" in the economy, but Qwest could "hold the numbers" if "the economy strengthen[s] in the second half." App.289a-90a. Szeliga confirmed at trial that she was "still confident in our guidance" at that point. CAJA-2240; App.292a-94a.

5. Two days later Qwest's April trading window opened. Nacchio sold 1.2 million shares before the window closed on May 15, but still not enough to catch up to the target he had set in October 2000. CAJA-4765. He then entered into an automatic plan to exercise 10,000 options per day so long as the stock price was above $38. CAJA-2000, 3044, 5158-59. Qwest's General Counsel, who knew everything Nacchio knew, "represented and warranted" that Nacchio had no material nonpublic information by approving the plan. CAJA-5157, 5172, 2201, 2222. After May 29, Qwest's stock fell below $38. CAJA-4761-63. Nacchio never sold another share and ended the year with more vested options than he had at the beginning. CAJA-4764-65.

6. *No one* told Nacchio the projections had to be reduced until August 15, 2001. App.232a-34a. After conducting an internal review, on September 10, 2001, Qwest issued a press release lowering its projections. CAJA-4933. Its stock price *increased* 10%. CAJA-4763. Nonetheless, Qwest stock declined dramatically throughout 2001 commensurate with the telecommunications index.

PROCEDURAL HISTORY

District Court Proceedings

1. Nacchio proposed instructions explaining that forward-looking statements are not materially misleading unless they lack "a reasonable basis," and that "data, assumptions, and methods" or "internal projections" need not be disclosed unless they are "so certain that they show the published figures to have been without a reasonable basis." App.341a-48a; CAJA-4162-64, 4180-82. The government also proposed instructions, drawn from this Court's opinion in *Basic*, clarifying that the materiality of predictive information requires a balancing of "probability" and "magnitude." App.338a-40a.

The district court held that those principles are "wholly inappropriate" "for this type of insider trading case." App.272a. It instructed the jury that "[i]*nformation may be material even if it relates not to* past events but to forecasting and forward-looking statements so long as a reasonable investor would consider it important in deciding to act or not to act with respect to the securities transaction at issue." App.274a.

2. After Judge Nottingham excluded under the Classified Information Procedures Act critical evidence regarding Nacchio's expectations of substantial IRU

revenues from clandestine government agencies, Nacchio's defense rested almost entirely on Fischel's expert testimony. Nacchio gave the prosecution notice, compliant with Rule 16, on March 29, 2007. App.300a-29a.

On April 3, the government filed a "Motion To Exclude Testimony By Daniel Fischel," arguing: (1) that Fischel's testimony was "irrelevant" and "would not assist the jury"; and (2) that "Defendant still has not complied with the [Rule 16] expert disclosure rules," and "[b]ased on that disclosure, Professor Fischel should be excluded." App.297a-99a. The prosecution repeatedly (but incorrectly) argued that the disclosure requirements under Criminal Rule 16 were the same as Civil Rule 26, and that Fischel's methodology was not sufficiently disclosed to permit *Daubert* evaluation. *E.g.*, CAJA-368, 408, 418-21.

Less than 24-hours later,[3] Nacchio responded by explaining that the testimony was relevant, App.333a-34a, and that he had disclosed everything required by Rule 16. App.330a-33a. Just before Judge Nottingham adjourned that day, he said he had not "look[ed] at" the issue, and was informed that Fischel would testify in the morning. App.247a.

The next morning, he told the government "I know you want a ruling, Mr. Stricklin, but—who is going to [cross]-examine Mr. [Fischel]?" App.251a. The court

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[3] That 24 hours included a full trial day and the second night of Passover. Nacchio had requested a brief adjournment so his lawyers could observe the holiday with their families, but the judge, after consulting with his "Jewish friends," Supp. App. 68, adjourned only one hour early on the first night so "[y]ou can go to eat gefiltefish [sic]," App.245a.

then expressed concern with the government's choice: "Really? Mr. Wise has taken a shot at him before." *Id.*

When the defense called Fischel, the court excused the jury. App.252a. Before either party could speak, he excluded Fischel's testimony on the grounds that Nacchio's Rule 16 notice had not established the reliability of Fischel's methodology under Rule 702. *E.g.*, App.253a ("[T]he deficiencies under *Daubert* and *Kumho Tire* in these disclosures are so egregious."). As the court later explained, it excluded Fischel because "[a]ny suggestion *that the Government was in possession of Fischel's ... methodology* is simply disingenuous" because *"[t]he March 29, 2007[] disclosure* [Nacchio's Rule 16 notice] contained no methodology or reliable application of methodology to the case. It was precisely that [nondisclosure] ... that led the Court ... to exclude much of Fischel's proposed testimony." App.269a. He also held that the proposed testimony was irrelevant, unnecessary, and unlikely to assist the jury because this was like "a simple negligence case." App.249a.

The defense asked: "Your Honor, may I be heard?" The court responded: "No." App.258a-259a. Although the court said it needed more information regarding methodology to make a reliability determination, it refused to let counsel speak or Fischel (who was in the courtroom) testify to the evidentiary foundation. The court then remarked that the trial was "way ahead of time" and "is going to be completed easily within probably half the time that ... was allotted to it," App.266a-67a, and excused the jury for the entire afternoon Thursday and until Monday morning.

Over the weekend, Nacchio filed a motion to reconsider and hold a *Daubert* hearing. App.336a-37a.

On Monday, Fischel gave a brief factual summary under FRE 1006 of the dates and amounts of Nacchio's trades. CAJA-3980. The defense again asked to elicit opinion testimony or for the requested *Daubert* hearing. CAJA-4064. With Fischel sitting in the witness chair, the court stated that "[t]here is no more disclosure or substantially no more disclosure than we originally had" in "the original expert report," and that "even if it were reliable, the Court remains of the conclusion that the testimony is of no relevancy." App.269a. It then again said "we're moving much faster than ever anticipated," and excused the jury until the following afternoon. App.269a-70a.

The government exploited that ruling in its closing argument, emphasizing its two analysts' unrebutted materiality testimony, CAJA-4278, 4501, and telling the jury that when the allegedly undisclosed information was disclosed "the stock price does drop," CAJA-4478. Nacchio was unable to show the jury Fischel's econometric analyses proving otherwise. App.112a; 7a.

Nacchio was acquitted of 23 counts covering trades in January-March, but convicted of 19 counts covering trades in April-May, and was sentenced to 72-months' imprisonment, fined $19 million, and ordered to forfeit $52 million.

Proceedings In The Tenth Circuit

1. The panel majority opinion, written by Judge McConnell, held that the district court misinterpreted Rule 16, which does not require a defendant to establish reliability under *Daubert*. App114a-19a. "Even reading the district court's ruling as a freestanding *Daubert* ruling rather than a finding that the Rule 16 disclosure was inadequate, such a ruling

would have been an abuse of discretion on this record, which is devoid of any factual basis on which a *Daubert* ruling could be made." App.119a-24a. The majority also reversed the district court's additional conclusions that the economic analysis was irrelevant and unhelpful, explaining that such testimony is "routine" in securities cases and endorsed by the commentary to Rule 702. App.124a-26a.

2. The panel rejected Nacchio's remaining arguments. It held that securities precedents articulating a high threshold for materiality of uncertain predictions were inapposite, since "Mr. Nacchio is being prosecuted for concealing true information while trading, not for making misleading statements." App136a.

The panel held that materiality "revolves around interpreting" Szeliga's December/January warning about a "'billion dollars of risk as it related to the target that we had set.'" App.141a (quoting App.230a). It acknowledged that on cross-examination Szeliga testified that she told Nacchio the risk related to the internal target, and therefore forecast only a 1.4% shortfall from the public numbers. App.141a-42a. But the panel concluded that "on re-direct examination, Ms. Szeliga corrected herself (*without saying so*), stating that the risk was closer to $1.2 billion and that it was against the public target at the time, not the private [internal] one." App.142a (emphasis added). It pointed to testimony where the government simply asked Szeliga to add and subtract numbers on a memo that would have indicated a 4.2% risk. *Id.* (citing App.239a-41a). The panel acknowledged that "Ms. Szeliga testified that Mr. Nacchio never saw the memo," but nonetheless accepted the government's (unsupported)

assertion that "she was talking to him about its contents." App.143a.[4] It concluded that "[g]iven Ms. Szeliga's [unstated] clarification on re-direct, the jury was entitled to believe that the higher figure was accurate." *Id.*

The panel said it was "a close question" whether a 4.2% shortfall was immaterial as a matter of law, App.143a, but concluded it was close enough to the SEC's 5% "guideline[] for the materiality of errors in reported revenues" because of "[s]pecial factors"—namely, Nacchio's assertion at a sales conference that a "skittish" and "mercurial" stock market could punish Qwest for even a small shortfall. App.140a, 143a.

The panel concluded that the "reasonable basis" instruction Nacchio proposed was confusing and inapposite in insider trading cases. The panel recognized that "it is important to give a jury enough guidance to sort out material information from noise," and that the district court's instruction was "not particularly informative," but held there was no reversible error because the instructions did not affirmatively "misstate[] the law." App.132a-34a.

4. The court granted rehearing *en banc* limited to whether the exclusion of Fischel was erroneous. App.169a-70a.

The *en banc* majority declined to consider the district court's Rule 16 and relevance errors. The majority acknowledged that the government "framed

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[4] The court ignored Szeliga's testimony that she "discussed the billion dollar risk with Mr. Nacchio ... not this—not the specifics of this memo," App.238a, and her unambiguous testimony that "a month into the year" "I thought we had a billion dollars of risk built into the stretch targets" (*i.e.*, the higher internal targets), App.232a.

its challenge to Professor Fischel's expert testimony as an objection to the sufficiency of Mr. Nacchio's Rule 16 disclosure," App.15a-16a, but found it significant that the motion argued that Nacchio's Rule 16 notice "had not established the admissibility of the evidence," under *Daubert* and Rule 702, App.8a. It held that the motion required Nacchio to "marshal his FRE 702 arguments," App.38a, and "set[] forth all available arguments for the testimony's admissibility," App.25a n.13, and that the district court could summarily exclude Fischel without permitting argument, *voir dire*, or a hearing.

The majority refused to consider whether the district court's misapprehensions concerning Rule 16 and relevance might have affected its discretionary decision to proceed in this manner, App.18a n.9, 46a n.21, and repeatedly relied on *Sprint/United Management Co. v. Mendelsohn*, 128 S. Ct. 1140 (2008), to presume that Judge Nottingham's ruling "rested on *Daubert* grounds," App.15a-16a, 11a n.6, 19a, while ignoring the *judge's own statement* that *Daubert* was *not* "the main bas[is] on which the Court rested its decision," and that Rule 16 *was* "one of multiple bases." App.350a.

The *en banc* court remanded to the panel to address unresolved sentencing and forfeiture issues.

Judge McConnell, joined by Chief Judge Henry and Judges Kelly and Murphy, dissented. They explained that in criminal cases an expert's methodology is almost always elicited on the stand, that the district court never ordered any different procedure here, and that Nacchio was entitled to respond to the government's motion by pointing out that Rule 16 simply does not require disclosures sufficient to satisfy

Daubert. Even if a *Daubert* challenge *had* been squarely presented, the dissenters reasoned that it was still a flagrant abuse of discretion and a violation of due process for the district court to exclude the testimony without permitting *voir dire* or a hearing—and that the *en banc* court's reasoning conflicted with other circuits. The dissenters criticized the majority's "unprecedented holding" that defendants are entitled to *no* notice about how a district court will resolve *Daubert* issues, which "will apply in all future cases, until ... the Supreme Court intercedes." App.74a. Finally, the dissenters explained that the court's misunderstandings of Rule 16 and relevance obviously infected its discretion, requiring a remand under *Koon v. United States*, 518 U.S. 81 (1996), and criticized the *en banc* court for ducking the issue. App.86a-92a.

Chief Judge Henry and Judge Kelly dissented in even more emphatic terms. App.93a-100a.

5. On March 5, 2009, Nacchio filed a Rule 33 motion for a new trial, explaining that Szeliga recently clarified in sworn deposition testimony that the "risk" she described to Nacchio was only a 1.4% shortfall in year-end revenues. The district court's consideration of that motion does not deprive this Court of jurisdiction. *United States v. Cronic*, 466 U.S. 648, 667 n.42 (1984).

REASONS FOR GRANTING THE WRIT

1. Even in civil securities cases, the SEC and other circuits have recognized that the materiality of risks or predictions about future events must be assessed under special rules and with great caution, because of the danger that a jury guided only by vague standards will find "fraud by hindsight." The Tenth Circuit's holding that such safeguards are inappropriate in

insider trading cases squarely conflicts with other circuits (which apply the same principles in trading cases), and introduces an illogical discontinuity into the law. Either the Tenth Circuit has opened a huge loophole for securities plaintiffs to evade settled law by re-pleading "false statement" cases as "insider trading" cases, or it believes (again contrary to settled law) that individuals must disclose more than the company when both sell stock.

More broadly, the standards governing the materiality of predictive information are highly unsettled and important. Other circuits regard uncertain internal predictions as not just immaterial but misleading, and would have punished Nacchio *for disclosing them*. Corporate executives deserve comprehensible standards, not capricious imprisonment.

2. Nacchio correctly identified a defect in the instructions, and proposed an alternative based on Seventh Circuit cases. The panel's holdings that Nacchio forfeited any challenge because his proposal was imperfect, and that the instructions given were acceptable merely because they did not "misstate" the law, conflict with decisions of this Court and other circuits.

3. The *en banc* court's *Daubert* analysis conflicts with decisions of several other circuits and merits review. Litigants are entitled to notice and an opportunity to lay an appropriate foundation for expert testimony. The Tenth Circuit's holding misunderstands the burden of proof on a motion *in limine*, and severely undermines the careful distinctions between the civil and criminal expert rules.

4. At a minimum, summary reversal is appropriate. The Tenth Circuit seriously misunderstood this Court's decisions in *Koon* and *Sprint*, mischaracterized the district court's decision, failed to resolve all the issues presented on appeal, and inexplicably held that Nacchio failed to address an issue that was a principal focus of his brief.

I. THE TENTH CIRCUIT'S MATERIALITY ANALYSIS MERITS REVIEW

A. The Tenth Circuit's Holding Conflicts With Other Circuits

The Tenth Circuit's materiality analysis conflicts with several other circuits, which have held that internal predictions and interim operating results are immaterial as a matter of law unless they establish a very strong likelihood that the company's eventual reported performance will be substantially below what the market is expecting.

1. The First Circuit has held that such information is material only if it establishes a "likelihood" of an "extreme departure" from market expectations, and the end of the reporting period is very close.

In *Shaw v. Digital Equipment Corp.*, the company sold stock while knowing of allegedly "material facts portending the unexpectedly large losses for the third quarter of fiscal 1994 that were announced later." 82 F.3d 1194, 1201-02 (1st Cir. 1996). The First Circuit held that "soft" information like internal *predictions* is always immaterial. *Id.* at 1211 n.21. Turning to the "hard" intra-quarterly operating results the company had in hand, the First Circuit "conceptualize[d]" the company "as an individual insider transacting in the company's securities," noted that whether "[p]resent, known information that strongly implies an important

future outcome ... must be disclosed (assuming the existence of a duty), poses a classic materiality issue," and held that the company could continue selling stock *without disclosing interim operating results* unless "the [seller] is in possession of nonpublic information indicating that the quarter in progress at the time of the public offering will be an extreme departure from the range of results which could be anticipated based on currently available information." *Id.* at 1203, 1210. That standard was satisfied in *Shaw* because the results were dire and the quarter-end was only eleven days away. But the First Circuit emphasized that claims based on information supposedly presaging results 4-6 months in the future have been dismissed because the omissions should be "deemed immaterial as a matter of law." *Id.* at 1210-11.

In *Glassman v. Computervision Corp.*, 90 F.3d 617 (1st Cir. 1996), the company knew that "as of week seven of the third quarter ... [sales] were only about *24% of Computervision's internal forecasts* for those weeks." *Id.* at 630. Although the end of the quarter was only five weeks away, and the stock later dropped 30% when quarterly results were announced, the First Circuit held that the company could sell its stock without disclosure because "the undisclosed hard information ... did not indicate a 'substantial likelihood that the quarter would turn out to be an extreme departure from publicly known trends and uncertainties.'" *Id.* at 631 (citation omitted); *see also In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997) (Alito, J.) (citing *Shaw* and *Glassman* as examples of "claims of omissions or misstatements that are obviously so unimportant that courts can rule them immaterial as a matter of law").

Other circuits reach similar results (in cases where the company was buying or selling stock) by holding that internal financial projections are immaterial unless the company knows them to be true "to a certainty." *Krim v. BancTexas Group, Inc.*, 989 F.2d 1435, 1449 (5th Cir. 1993); *see also Walker v. Action Indus., Inc.*, 802 F.2d 703, 708-10 (4th Cir. 1986) (collecting case law, and holding that company had no duty to disclose dramatic increase in first quarter "actual orders" and "projected sales" because longer term consequences were still "uncertain"), *cert. denied*, 479 U.S. 1065 (1987). The Seventh Circuit holds that internal projections *never* have to be disclosed, unless projections have been released and "the internal estimates are so certain that they reveal the published figures as materially misleading" and lacking in any "reasonable basis."[5] *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 515-16 (7th Cir. 1989) (Easterbrook, J.); *see also Walker*, 802 F.2d at 708 (concluding that Second Circuit agrees with the Seventh). *Vaughn v. Teledyne, Inc.*, 628 F.2d 1214, 1221 n.7 (9th Cir. 1980) ("partial disclosure of financial projections *makes* them material facts.").

2. Nacchio would be entitled to acquittal under any of those standards. Szeliga's forecast of 4.2% "risk" to the 2001 projections is "soft" information about highly uncertain events nearly a year in the future. The combined estimates from the business units *always* exceeded the public projections, and *no one* at Qwest

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[5] The "reasonable basis" language comes from SEC safe harbors precluding any theory of securities liability premised on an assertion that public projections are materially misleading, if those projections have a reasonable basis. 17 C.F.R. §§230.175(a), 240.3b-6(a).

advised Nacchio to reduce the projections until months after his last trade. The IRU risk Casey identified in April was small and based on his inherently uncertain predictions about the broader economy. *Supra* 6; *Krim*, 989 F.2d at 1449 (economic forecasts not material); *Wielgos*, 892 F.2d at 515 (securities laws require disclosure of *firm-specific* information).

The "hard" interim operating results that Nacchio had in April or May 2001 did not "indicate a 'substantial likelihood that the quarter would turn out to be an extreme departure from publicly known trends and uncertainties.'" *Glassman*, 90 F.3d at 631. Qwest *met* expectations in the first and second quarters. In *Glassman*, the company knew five weeks before the end of the quarter that its sales *for that quarter* were running at only 24% of internal projections, and the First Circuit held that knowledge was immaterial as a matter of law. Qwest's "recurring" revenue growth was disappointing but its other revenue sources were running above budget, and that shift *was disclosed.* *Supra* 5-7. Nacchio also knew (and Casey did not) about Qwest's prospects to receive substantial IRU revenues from classified government contracts. CAJA-2396-2400.

The panel was unpersuaded—and erroneously held that the court's exclusion of the classified information was harmless—because it believed that negative and positive information cannot offset each other. "If an insider trades on the basis of his perception of the net effect of two bits of material undisclosed information, he has violated the law in two respects, not none." App.128a. That might be fair, except that the sole theory of materiality charged or tried in this case was that Nacchio knew, "from early in 2001 through

September 2001, that the business units were underperforming with regard to their specific internal budgets, and that *such under-performance would inhibit Qwest's ability to meet its 2001 financial guidance issued on September 7, 2000.*" App.219a (emphasis added). The panel understood that the charge was solely that Nacchio knew of material undisclosed risks *to the projections*, App.103a-04a, 109a, 143a, and held that Szeliga's "risk" prediction could be material, despite the SEC's guidance in SAB 99, only because the "skittish" and "mercurial" stock market would react negatively to any shortfall *as compared to the projections*. App.143a-44a.

Finally, even if any "risk" of a 4.2% shortfall eight months in the future were treated as a certainty, that is not "an extreme departure" and did not "forebod[e] disastrous [year]-end results." *Shaw*, 82 F.3d at 1210. As the Tenth Circuit acknowledged, that risk was less than the threshold for materiality of errors in *already reported* revenues under SEC guidelines. Other circuits have held that shortfalls in this range are immaterial. *See In re Apple Computer, Inc.*, 127 Fed. Appx. 296, 304 (9th Cir. 2005) ("[A] revenue estimate that was missed by approximately 10% was immaterial as a matter of law").

3. The Tenth Circuit erroneously held that the case law discussed above applies only in *false statement* cases. Many of these cases involved stock sales or purchases by the company in addition to allegedly misleading statements. In *Shaw* and *Glassman* the companies were *selling stock* without disclosing the dire shortfalls they were experiencing. The First Circuit expressly "conceptualize[d]" the company "as an individual insider transacting in the company's

securities." *Shaw*, 82 F.3d at 1203. In *Wielgos*, the company was similarly accused of *selling stock* with a registration statement incorporating cost projections lower than the company's own internal estimates. 892 F.2d at 512. And the Seventh Circuit has rejected insider trading claims against individuals based on internal predictions. *See Freeman v. Decio*, 584 F.2d 186, 198-200 (7th Cir. 1978). This Court explained in *Basic* that the materiality standard does not vary "depending on who brings the action or whether insiders are alleged to have profited." 485 U.S. at 240 n.18. The Tenth Circuit's distinction wrongly suggests that if the plaintiffs in cases like *Glassman* and *Wielgos* had just accused the company of insider trading rather than misleading statements they would have won. These are crucial substantive rules, not mere pleading issues.

Perhaps the Tenth Circuit was confused by the fact that the "reasonable basis" safe harbor directly applies only to claims that public projections are materially misleading. But the relevance of *Wielgos*, and the point of Nacchio's proposed instructions, is that under Seventh Circuit precedent an internal projection is categorically immaterial and need not be disclosed. (The First Circuit agrees, *Shaw*, 82 F.3d at 1211 n.21.) The only exception is *if* a public projection has been made *and* "the internal estimates are so certain that they reveal the published figures as materially misleading"—which brings into play the SEC's regulations about when a public projection can be deemed misleading for purposes of *any* theory of securities liability. *Wielgos*, 892 F.2d at 515-16. As a matter of law, therefore, Szeliga's risk assessment could be material only if it reveals that publicly issued

projections lack any reasonable basis.[6] Yet the district court wrongly told the jury that Qwest's disclosure obligations were *irrelevant*, which also decimated Nacchio's scienter defense. App.274a-75a.

The only real way to distinguish "company trading" cases like *Shaw*, *Glassman*, *Wielgos*, etc., from individual insider trading cases would be if companies do not have the same duty to disclose material information before trading that individuals have. The consensus has been that corporations do have that duty,[7] but a circuit split has developed. *See J&R Mktg., SEP v. GMC*, 549 F.3d 384, 396-97 (6th Cir. 2008) (declining "to impose upon issuers the same duty faced by those who engage in insider trading"). If the Tenth Circuit has implicitly joined the Sixth, that conflict too merits review.

Finally, in at least the Seventh and Ninth Circuits an internal projection *cannot* be released unless it is "reasonably certain," a standard plainly not met here. *Panter v. Marshall Field & Co.*, 646 F.2d 271, 291-93 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Vaughn*,

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[6] The panel unfairly accused Nacchio of conflating the duties to "disclose or abstain." App.136a-37a. The two sometimes converge in omissions cases but are distinct in many common fact patterns.

[7] *See Shaw*, 82 F.3d at 1203 ("Courts ... have treated a corporation trading in its own securities as an 'insider' for purposes of the 'disclose or abstain' rule."); *N.J. Carpenters Pension & Annuity Funds v. Biogen IDEC Inc.*, 537 F.3d 35, 56 n.21 (1st Cir. 2008) (same); *McCormick v. Fund Am. Cos.*, 26 F.3d 869, 876 (9th Cir. 1994) (collecting "[n]umerous authorities" holding that corporate issuers and individual insiders are subject to same rules); Loewenstein & Wang, *The Corporation As Insider Trader*, 30 Del. J. Corp. L. 45, 77 (2005) (same); *id.* at 58 n.48, 62 nn.57-58, 66 n.74 (collecting authorities); 7 Loss & Seligman, *Securities Regulation* 3499 (3d ed. rev. 2003) (same).

628 F.2d at 1221. The Tenth Circuit is sending Nacchio to prison for selling stock without disclosing conflicting predictions (worries, really) by his employees that other circuits would regard as misleading and punish him for disclosing. This is terribly unfair, particularly when criminal conviction requires proof that the defendant *knew* the information was material, App.147a, and vividly illustrates the depth of confusion in the lower courts.

4. The Tenth Circuit suggested in a footnote that "in this case the parties have focused solely on the magnitude of the shortfall, should it occur," not "the probability that the event will occur." App.144a n.10 (citing App.361a). That clear error should be ignored (or summarily reversed). The Tenth Circuit was citing section I.B.2.b., a *one-page* section of Nacchio's brief—but overlooked section I.B.2.a., titled: "*At the time of the trades, the information available to Nacchio did not reveal, to* any *degree of certainty, that Qwest would fail to meet its year-end numbers eight months in the future,*" App.356a-60a—a *five-page section* (nearly 10% of Nacchio's brief), that argued that the information was too uncertain to be material, citing (*inter alia*) *Shaw* and *Wielgos*.

B. The Materiality Issues Present Questions Of National Importance

In the more than twenty years since this Court last addressed the issue in *Basic*, "[f]orward looking information probably has been the most prolific subject of securities fraud litigation." 3 *Bromberg and Lowenfels on Securities Fraud & Commodities Fraud* §6:5 (2d ed. 2008). The materiality of such information is a question of great national importance that "[n]either the Securities and Exchange Commission

(SEC) nor the [lower] courts have answered ... with either uniformity or clarity." Gulati, *When Corporate Managers Fear a Good Thing Is Coming to an End: The Case of Interim Nondisclosure*, 46 U.C.L.A. L. Rev. 675, 678 (1999).[8]

As a practical matter, the Tenth Circuit's reasoning puts companies and executives in an impossible position. Every corporation produces a constant stream of conflicting opinions, estimates, and projections. A high threshold for the materiality of internal forecasts (or of interim operating data alleged to be material only because of what it supposedly portends for the future) is essential to basic corporate functioning. Companies cannot bare their internal debates and forecasting process to the public and to

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[8] Commentators agree the governing standards are "uncertain," *id.* at 728-29, "unresolved," Gwyn & Matton, *The Duty to Update the Forecasts, Predictions, and Projections of Public Companies*, 24 Sec. Reg. L.J. 366, 366 (1997), an "endemic hazard" that makes it "especially difficult" for managers to determine what is material, Rosen, *Liability for "Soft Information": New Developments and Emerging Trends*, 23 Sec. Reg. L.J. 3, 3, 43 (1995), "a controversial topic" that has "troubled" courts because of the "concern[] over imposing potentially enormous liability [including, in this case, *imprisonment*] for failure to disclose such potentially uncertain information," Hiler, *The SEC and the Courts' Approach to Disclosure of Earnings Projections, Asset Appraisals, and Other Soft Information: Old Problems, Changing Views*, 46 Md. L. Rev. 1114, 1129, 1195 (1987), that "[t]he confusion has turned to a hopeless clutter," Langevoort & Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 Vand. L. Rev. 1639, 1641-42 (2004), and that "[i]t is difficult to state precisely what the law is ... because there are inconsistent holdings and dicta in the cases to support both plaintiffs and defendants on a number of key issues," Schneider, *Soft Disclosure: Thrusts & Parries When Bad News Follows Optimistic Statements*, 26 Rev. Sec. & Commodities Reg. 33, 33 (1993).

competitors, and investors would not be well served if they tried. *See TSC Indus., Inc. v. Northway*, 426 U.S. 438, 448-49 (1976) ("[B]ury[ing] the shareholders in an avalanche of trivial information ... is hardly conducive to informed decisionmaking."); *Walker*, 802 F.2d at 710 (disclosure of internal projections would be "impractical" and likely to mislead); *Wielgos*, 892 F.2d at 516 (such a requirement would prevent companies from raising capital).

The practical effect of the Tenth Circuit's holding will be that corporate insiders cannot buy or sell company shares *ever*. That will reduce the value of company stock and options in compensation, and deprive the market of information (executive trading decisions) that actually *is* useful to investors. It will also seriously discourage companies from issuing projections at all. Nacchio's inside information was supposedly "material" here *only* because Qwest had first made public projections. *Supra* 13, 20-21. If making a projection can render internal forecasts and interim results "material," and subject executives to criminal liability, without reasonable safeguards like those applied in *Shaw* and *Wielgos*, companies will not do it.

II. THE TENTH CIRCUIT'S INSTRUCTIONAL ANALYSIS CONFLICTS WITH OTHER CIRCUITS

1. The Tenth Circuit acknowledged that the skeletal materiality instruction was "not particularly informative," but held there could be no reversible error unless it affirmatively "misstated the law." App.133a-34a.

That is the wrong standard. "A trial judge's duty is to give instructions sufficient to explain the law," *Kelly*

v. South Carolina, 534 U.S. 246, 256 (2002), and an instruction is erroneous if it does not "contain[] an adequate statement of the law to guide the jury's determination," *United States v. Park*, 421 U.S. 658, 675 (1975). Other circuits have held that reversible error occurs when a facially correct instruction is "'incomplete[],'" *United States v. Escobar-de Jesus*, 187 F.3d 148, 164 n.10 (1st Cir. 1999) (citation omitted), *cert. denied*, 528 U.S. 1176 (2000), or "'inadequate to guide the jury's deliberations,'" *United States v. Marsh*, 894 F.2d 1035, 1040 (9th Cir. 1989) (citation omitted), *cert. denied*, 493 U.S. 1083 (1990). *See also United States v. Dotson*, 895 F.2d 263, 264 (6th Cir.) (reversing "correct ... but not sufficient" instruction), *cert. denied*, 498 U.S. 831 (1990); *Kisor v. Johns-Manville Corp.*, 783 F.2d 1337, 1340 (9th Cir. 1986); *United States v. Holley*, 502 F.2d 273, 276 (4th Cir. 1974); *United States v. Gordon*, 290 F.3d 539, 545 (3d Cir.), *cert. denied*, 537 U.S. 1063 (2002); *United States v. Hastings*, 918 F.2d 369, 373 (2d Cir. 1990).

2. The Tenth Circuit held that Nacchio's "reasonable basis" instruction was confusing and did not accurately state the law as the court of appeals viewed it. Even if his proposed fix was not perfect, Nacchio correctly identified that the instructions gave inadequate guidance on materiality in these circumstances.

In at least seven circuits, "'[t]he fact that counsel did not tender perfect instructions does not immunize from scrutiny on appeal a failure to instruct the jury adequately concerning the issues in the case.'" *Heller Int'l Corp. v. Sharp*, 974 F.2d 850, 856 (7th Cir. 1992) (citation omitted); *see also Webster v. Edward D. Jones & Co.*, 197 F.3d 815, 820 (6th Cir. 1999) ("'[E]ven if an

incorrect proposed instruction is submitted which raises an important issue of law involved in light of proof adduced in the case, it becomes the duty of the trial court to frame a proper instruction on the issue raised ....'") (citation omitted); *Wilson v. Maritime Overseas Corp.*, 150 F.3d 1, 10 (1st Cir. 1998) (same); *Bueno v. City of Donna*, 714 F.2d 484, 490 (5th Cir. 1983) (same); *Walker v. AT&T Techs.*, 995 F.2d 846, 849 (8th Cir. 1993) (same); *United States v. Jones*, 909 F.2d 533, 538-39 (D.C. Cir. 1990) (Ginsburg, R., J.) (same); *Posttape Assocs. v. Eastman Kodak Co.*, 537 F.2d 751, 757 (3d Cir. 1976) (same).

III. THE TENTH CIRCUIT'S *DAUBERT* ANALYSIS CONFLICTS WITH OTHER CIRCUITS AND MERITS REVIEW

1. The Tenth Circuit held the government's motion was based on "Nacchio's failure to carry his burden to demonstrate that Professor Fischel's testimony was admissible." App.21a, 24a-25a & n.13, 22a n.11, 33a & n.16. It cites no case or rule requiring Nacchio to establish reliability in response to a motion to exclude, concedes that Nacchio's expectation of establishing reliability on the stand "may have been reasonable," but still concludes the district court had no "obligation to provide specific notice" that the *Daubert* issue would be resolved in some other way. App.21a-22a & n.10.

Of course Nacchio bore the ultimate burden of laying a sufficient foundation for admissibility at trial. But when a litigant moves *in limine* to exclude evidence *the movant* bears the burden of producing facts sufficient to require a hearing or exclusion. The posture is like summary judgment, where the movant has the *prima facie* burden to prove the absence of a triable dispute. Such motions should be *denied* without

a hearing if the movant relies only on the opponent's ultimate burden of proof. *See United States v. Stoddart*, 48 Fed. Appx. 376, 380 (3d Cir. 2002) (upholding denial of motion to suppress without a hearing where defendant "merely relies upon the government's 'burden of proof to establish adequate *Miranda* warnings'") (citation omitted); *United States v. Howell*, 231 F.3d 615, 621 (9th Cir. 2000) (same), *cert. denied*, 534 U.S. 831 (2001). A motion to exclude certainly cannot be *granted* on such a thin basis.

The government never made even a *prima facie* showing of unreliability; it simply argued that Fischel's methodology was undisclosed. The district court could have accelerated Nacchio's burden by clearly ordering him to proffer the grounds for Fischel's admissibility in writing. Contrary to the *en banc* court's reasoning, however, the mere filing of a motion pointing out that the foundation has not yet been laid *does* not alert the defendant that he may be precluded from laying that foundation at the usual time—on the stand.

This Court has explained that when a movant "call[s] sufficiently into question" the reliability of expert testimony, the court must hold "appropriate proceedings" to "investigate reliability," which can include "special briefing" or "other proceedings," where the judge is to "ask questions." *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 149, 151-52 (1999). None of that would be necessary if the expert could be excluded merely because the proponent had not yet proven reliability.

The Third Circuit has reversed district courts for granting *Daubert* motions without a hearing, when the record was insufficient to allow an assessment of

reliability.[9] If merely filing a motion notifies the proponent that he must establish reliability before the court rules, then all those cases would have come out the other way. The Third Circuit consistently holds that "failure to hold a hearing"—regardless of whether the proponent requests one—constitutes "an abuse of discretion where the evidentiary record is insufficient to allow a district court to determine what methodology was employed by the expert in arriving at his conclusions." *Murray v. Marina Dist. Dev. Co.*, No. 07-1147, 2008 WL 2265300, at *2 (3d Cir. June 4, 2008) (unpublished); *Padillas v. Stork-Gamco, Inc.*, 186 F.3d 412, 417-18 (3d Cir. 1999) (explaining that it was "immaterial" that the proponent had not requested a hearing before the exclusion).

Other circuits agree. The Sixth Circuit has reversed the exclusion of an expert because "a district court should not make a *Daubert* determination when the record is not adequate to the task." *Jahn v. Equine Servs., PSC*, 233 F.3d 382, 393 (6th Cir. 2000); *see also Busch v. Dyno Nobel, Inc.*, 40 Fed. Appx. 947, 961 (6th

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[9] *See, e.g., In re Paoli R.R. Yard PCB Litig.*, 916 F.2d 829, 854-55 (3d Cir. 1990) (reversing exclusion because the district court did not "provide[] the [proponents] with sufficient process for defending their evidentiary submissions" and "should have been given an opportunity to be heard on the critical issues before being effectively dispatched from court"), *cert. denied*, 499 U.S. 961 (1991); *Padillas v. Stork-Gamco, Inc.*, 186 F.3d 412, 418 (3d Cir. 1999) (reversing exclusion of expert without hearing where report did not disclose methodology because that did not "establish that [the expert] may not have 'good grounds' for his opinions, but rather, that they are insufficiently explained and the reasons and foundations for them inadequately and perhaps confusingly explicated" and thus the proponent must have an "opportunity to respond to the court's concerns") (citation omitted).

Cir. 2002) ("district court ... is charged with the responsibility of ensuring that the record before the court is adequate"). The First Circuit has explained that "courts will be hard-pressed in all but the most clearcut cases to gauge the reliability of expert proof on a truncated record" and "must be cautious—except when defects are obvious on the face of a proffer—not to exclude debatable scientific evidence without affording the proponent of the evidence adequate opportunity to defend its admissibility." *Cortes-Irizarry v. Corporacion Insular de Seguros*, 111 F.3d 184, 188 (1st Cir. 1997). The advisory committee notes to Rule 702's 2000 amendments endorse *Cortes-Irizarry* and *In re Paoli Railroad Yard PCB Litigation* as examples of how courts should "consider[] challenges to expert testimony under *Daubert*."

Commentators agree that *Kumho Tire* and basic evidentiary principles require a movant seeking to exclude expert testimony to establish serious reasons for doubting its reliability, on an adequate evidentiary record.[10] This is an important and recurring issue on which the lower courts are divided.

2. The Tenth Circuit's decision also transforms criminal expert practice. Criminal defendants have *no* obligation under Rule 16 to offer disclosures sufficient to justify the admissibility of an expert's testimony under *Daubert*, and ordinarily may establish the

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[10] Goodwin, *The Hidden Significance of Kumho Tire*, 52 Baylor L. Rev. 603, 626-32 (2000) (movant must establish a "threshold level of unreliability" by "call[ing] [reliability] sufficiently into question"); Berger, *Procedural Paradigms for Applying the* Daubert *Test*, 78 Minn. L. Rev. 1345, 1365 (1994) ("[T]he evidence should be presumed to be admissible until the opponent discharges its burden to show the contrary.").

reliability of expert testimony by questioning the witness. App.114a-24a. But the Tenth Circuit has now held that the government can force defendants to supply such disclosures—the equivalent of a civil expert report and "all available arguments for the testimony's admissibility," App.25a n.13—simply by filing a motion pointing out that the defendant has not yet disclosed what the rules did not require him to disclose. The government will exploit this loophole in every case, collapsing the civil and criminal expert rules and threatening the constitutional principle that a defendant cannot be forced to prematurely disclose his defense. The consequences for the administration of justice merit review.

IV. SUMMARY REVERSAL IS WARRANTED

This case merits plenary review, but at a bare minimum should be summarily reversed.

1. Even if the judge was entitled to exclude Fischel under *Daubert*, doing so without permitting a hearing, *voir dire*, or argument was an exercise of discretion. The *en banc* court granted rehearing on whether the district court abused its discretion. App.46a n.21. Nacchio pointed out that "'[t]he abuse-of-discretion standard includes review to determine that the discretion was not guided by erroneous legal conclusions,'" and that the court's discretion was obviously infected by its erroneous belief that Nacchio had committed an egregious Rule 16 violation, and that the proposed testimony was irrelevant and unhelpful. *En Banc* Reply Br. at 22-23.

The *en banc* court held that this argument either was not within the *en banc* grant or that it is frivolous and does not "merit analytical attention." App.46a n.21. Both suggestions are flatly inconsistent with

settled law. App.86a-92a (McConnell, J., dissenting). The *en banc* court also cannot take for itself, and away from the panel, the authority and responsibility to decide whether the district court abused its discretion—and then simply refuse to consider one aspect of that issue such that it falls through a crack between the decisions and cannot be resolved. When an appellate court simply refuses to resolve a material issue, it departs from the usual course of judicial proceedings and calls for this Court's supervisory power.

2. The *en banc* court repeatedly cites *Sprint* to presume that the district court's order excluding Fischel "rested on *Daubert* grounds," App.15a-16a, 11a n.6, 19a, and not on its misinterpretation of Rule 16, notwithstanding the district judge's express statement that *Daubert* was *not* "the main bas[is] on which the Court rested its decision." App.350a. In *Sprint* this Court reversed the Tenth Circuit for presuming that an ambiguous district court opinion rested on erroneous grounds, and held that "[a] remand directing the district court to clarify its order ... would have been the better approach." 128 S. Ct. at 1146. The *en banc* court here committed the very same error in reverse. This Court often summarily reverses when a court of appeals simply misunderstands this Court's recent precedents, *e.g.*, *Nelson v. United States*, 129 S. Ct. 890 (2009); *Spears v. United States*, 129 S. Ct. 840 (2009), or when the court of appeals reverses when it should have remanded, *e.g.*, *INS v. Ventura*, 537 U.S. 12 (2002); *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504 (2001).

3. The panel's footnoted suggestion that Nacchio did not argue that Szeliga's prediction was immaterial

because of its uncertain nature is inexplicable plain error that warrants summary reversal. *Supra* 24; *see Dye v. Hofbauer*, 546 U.S. 1, 3-4 (2005) (summary reversal where circuit held that defendant failed to raise argument when "[t]he fourth argument heading in his brief" plainly "sets out the ... claim"). Any attention to the uncertainties inherent in Szeliga's forecast should have led the panel to conclude that it was immaterial as a matter of law—since that was a "close question" on magnitude grounds alone. App.143a.

4. Finally, a brief review of the record, App.252a-59a, 268a-69a, will demonstrate that the panel and *en banc* dissent correctly described the basis of the district court's decision to exclude Fischel, and confirm their conclusion that an appalling injustice was done here. It cannot possibly be within a judge's discretion to exclude a criminal defendant's only substantive witness because he needs more information to assess methodology while simultaneously prohibiting counsel and the witness from providing it, and to then excuse the jury for much of the next four court days because "we're moving much faster than ever anticipated" and need "to slow down just for a little bit." App.269a-270a. This was a "draconian decision" that "flies in the face of the truth-finding goals of trial, the constitutional safeguards to a full defense, [and] the liberal thrust of the rules of evidence," App.99a (Henry, CJ, dissenting), and the *en banc* majority's zeal to defend it on grounds contrary to the district court's express language (and to call Nacchio, his lawyers, and Judge McConnell and the dissenters "disingenuous," App.27a), is alarming. With respect, and appreciation for the limits of this Court's role, the administration of justice would benefit

from a reminder that unpopular high-profile defendants are still entitled to basic fairness. *See Moore v. United States*, 129 S. Ct. 4 (2008) (summarily reversing when circuit mischaracterized basis for district court's ruling).

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX

FILED
United States Court of Appeals
Tenth Circuit

February 25, 2009

Elisabeth A. Shumaker
Clerk of Court

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

UNITED STATES OF AMERICA, Plaintiff - Appellee, v. JOSEPH P. NACCHIO, Defendant - Appellant.	No. 07-1311

Appeal from the United States District Court for the District of Colorado (D.C. No. 05-CR-545-N)

Maureen E. Mahoney of Latham & Watkins LLP, Washington, DC (Alexandra A.E. Shapiro, J. Scott Ballenger, and Nathan H. Seltzer of Latham & Watkins LLP, Washington, DC; and Herbert J. Stern and Jeffrey Speiser of Stern & Kilcullen, Roseland, NJ, with her on the briefs), for Defendant-Appellant.

Edwin S. Kneedler, Deputy Solicitor General, Office of the Solicitor General, Department of Justice, Washington, DC (Troy A. Eid, United States Attorney, and James O. Hearty and Kevin T. Traskos, Assistant United States Attorneys, District of Colorado; and Leo J. Wise and Stephan E. Oestreicher Jr., Attorneys, Criminal Division, Department of Justice, Washington, DC, with him on the briefs), for Plaintiff-Appellee.

Andrew H. Schapiro, Mayer Brown LLP, New York, NY; and Barbara E. Bergman, National Association of Criminal Defense Lawyers, Albuquerque, NM, filed an amicus curiae brief for the National Association of Criminal Defense Lawyers.

Before **HENRY**, Chief Judge, **TACHA**, **KELLY**, **BRISCOE**, **LUCERO**, **MURPHY**, **HARTZ**, **MCCONNELL**, and **HOLMES**, Circuit Judges.

OPINION ON REHEARING EN BANC

HOLMES, Circuit Judge, joined by **TACHA**, **BRISCOE**, **LUCERO**, and **HARTZ**, Circuit Judges.

A jury convicted Joseph Nacchio, the former CEO of Qwest Communications International, Inc. ("Qwest"), of nineteen counts of insider trading. On appeal, Mr. Nacchio challenged his conviction, his sentence, and the forfeiture of his assets. Regarding his conviction, he argued that the evidence was insufficient to convict him, that the jury was improperly instructed, and that the trial judge

incorrectly excluded both expert-testimony evidence and classified information important to his defense. A divided panel of this Court affirmed on the sufficiency of the evidence, jury instruction, and classified information issues but held that the expert testimony had been improperly excluded. The panel did not reach the challenges that Mr. Nacchio raised to the forfeiture of his assets or his sentencing enhancement. Thus, the case was reversed and remanded for a new trial. *See United States v. Nacchio* ("*Nacchio I*"), 519 F.3d 1140 (10th Cir. 2008).

We granted rehearing en banc to consider the expert testimony issue.[1] In accordance with our local rule, the judgment was vacated, the mandate stayed, and the case was restored as a pending appeal. *See* 10th Cir. R. 35.6. On rehearing en banc, we hold that the expert testimony was properly excluded and affirm the district court's judgment. We now vacate the panel opinion insofar as it reversed the district court's judgment, including Parts II(A), IV, and V, as well as

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[1] On rehearing en banc we asked the parties to brief the following:

> [(1)] Was the defendant sufficiently on notice that he was required either to present evidence in support of the expert's methodology or request an evidentiary hearing in advance of presenting the expert's testimony? [(2)] Did the defendant have an adequate opportunity to present such evidence or request an evidentiary hearing in advance of presenting the expert's testimony? [(3)] Did the defendant bear the burden of requesting an evidentiary hearing? [(4)] Did the district court abuse its discretion in disallowing the evidence, and if so, is the appropriate remedy necessarily a new trial, or is a remand for purposes of conducting an evidentiary hearing adequate?

United States v. Nacchio, 535 F.3d 1165 (10th Cir. 2008) (order granting petition for rehearing en banc).

the separate concurring and dissenting opinion. The remainder of the panel's decision remains in effect.

I. BACKGROUND

As the panel opinion provides a full recitation of the factual background, *see Nacchio I*, 519 F.3d at 1144-48, we discuss only the relevant events and rulings as needed to frame our analysis. The government had alleged that Mr. Nacchio, the former CEO of Qwest, made sales of shares of Qwest stock from January to May 2001 on the basis of material, nonpublic information. The jury trial commenced after more than a year of discovery and motions in limine, during which Mr. Nacchio disclosed no expert witness.

On March 16, 2007—three days prior to the start of trial—Mr. Nacchio first disclosed, pursuant to Fed. R. Crim. P. 16(b)(1)(C) ("Rule 16"), that he planned to call to the stand Professor Daniel Fischel as an expert. Under certain circumstances, Rule 16 requires a defendant to provide to the government, upon request, a written summary of any expert testimony that the defendant intends to use as evidence at trial under Federal Rules of Evidence ("FRE") 702, 703, or 705. "This summary must describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications." Fed. R. Crim. P. 16(b)(1)(C).

It is undisputed that a Rule 16 disclosure was required in this case, because Mr. Nacchio previously had requested, pursuant to Fed. R. Crim. P. 16(a)(1)(G), a summary of any expert testimony the government intended to use during its case-in-chief at trial. Aplee. Supp. En Banc App. 3. The provisions of Rule 16 are "intended to meet [the need for counsel to learn that an expert is expected to testify] by first, requiring notice of the expert's qualifications which in

turn will permit the requesting party to determine whether in fact the witness is an expert within the definition of Federal Rule of Evidence 702." Fed. R. Crim. P. 16 advisory committee's note (1993). Next, "the requesting party is entitled to a summary of the expected testimony." *Id.* And finally, "and *perhaps most important*, the requesting party is to be provided with a summary of the bases of the expert's opinion." *Id.* (emphasis added).

Pursuant to Rule 16, Mr. Nacchio provided the government with a short summary of Professor Fischel's anticipated testimony as well as his curriculum vitae. Aplt. App. 460. The government objected that the disclosure did not satisfy the requirements of Rule 16 and requested a complete, proper disclosure. Aplee. Supp. App. 35. The government's objection additionally highlighted shortcomings of the disclosure under various rules of evidence, including FRE 702, and it included several references to the expert testimony requirements of *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993). Aplee. Supp. App. 35, 38-42. The district court agreed that Mr. Nacchio's notice did not comply with Rule 16 because it "offer[ed] no bases or reasons whatsoever for Professor Fischel's opinions contained in the summary" and stated that "[t]he matter may be settled through analysis under Rule 16." Aplt. App. 349-52. The district court also noted, however, the government's additional assertion that the disclosure did not satisfy "[FRE] 401, 403, 602, 702, and 704." Aplt. App. 351. The district court instructed that "Defendant shall produce an expert disclosure *compliant with the federal rules described herein* by March 26, 2007." Aplt. App. 352 (emphasis added).

On March 22, 2007, while the jury was dismissed, the district court granted Mr. Nacchio three extra days to provide his revised Rule 16 disclosure. In doing so, the district court judge stated that he was "flabbergasted ... that [Mr. Nacchio] could think that was an adequate expert disclosure" and that "I think the rule is pretty clear, and ... it's pretty close to what is required in the civil area."[2] Aplt. App. 2038, 2041. The following exchange then took place:

> [GOV'T ATTORNEY]: [I]t's my concern at least based on the way the disclosure is raised right now, there could be Daubert issues that arise with respect to certain parts of the testimony....
>
> THE COURT: Probably not Daubert, but maybe Kumho Tire issues.
>
> [GOV'T ATTORNEY]: Yes, I misspoke.
>
> [DEFENSE COUNSEL]: In Latin, *forewarned is forearmed.*
>
> THE COURT: That's not Latin.
>
> [DEFENSE COUNSEL]: No, but I don't speak Latin.

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[2] Whether the district court viewed the operative criminal discovery standards as being roughly conterminous with civil discovery standards, and therefore erred in its *Rule 16 determination*, is not—as the principal dissent suggests—material to our resolution of this matter. *See* Dissenting Op. at 2-5 (McConnell, J., dissenting) [hereinafter Dissenting Op.]. As discussed further herein, by the time the district court issued its exclusion ruling, the front-and-center issue was the reliability of Professor Fischel's proferred expert testimony under *Daubert* and FRE 702, and it was upon that ground that the district court primarily acted to exclude Professor Fischel's testimony, concluding that Mr. Nacchio had failed to make an adequate showing that the testimony was reliable.

THE COURT: All right.

Aplt. App. 2041-42 (emphasis added).

Mr. Nacchio provided a revised Rule 16 disclosure on March 29 which summarized Professor Fischel's qualifications as an academic, his research and teaching in law and finance, and his previous experience both consulting and testifying. The disclosure outlined the bases for Professor Fischel's opinions and highlighted specific expected areas of testimony as well as the documents and data reviewed by Professor Fischel in connection with this matter. Aplt. App. 425-34. This revised Rule 16 disclosure explained that in reaching his conclusions, Professor Fischel had conducted a "study of the Questioned Sales in relation to various benchmarks and other relevant criteria." Aplt. App. 427. The revised disclosure also noted that Professor Fischel had analyzed Qwest's guidance, its actual stock performance, and reaction from the investment community; Qwest's guidance history compared to the guidance history of other telecommunications firms; and various facets of Qwest's revenue from indefeasible rights of use. Aplt. App. 430-32.

On Tuesday, April 3, the government filed a 63-page motion to exclude Professor Fischel's expert testimony. Aplt. App. 362. In this motion, the government thoroughly addressed the standards and case law of Rule 16 and FRE 401, 403, 602, 702, and 703, and discussed them in the context of Professor Fischel's qualifications and relative to each of his opinions as set forth in the revised Rule 16 disclosure. Aplt. App. 367-418. Included throughout were references to Professor Fischel's methodology and

arguments regarding the role of *Daubert*[3] and FRE 702's reliability requirement in establishing the admissibility of expert testimony. *See, e.g.*, Aplt. App. 385, 388, 390, 405, 408. The government asserted that not only had Mr. Nacchio failed to comply with Rule 16, but that Mr. Nacchio had not established the admissibility of the evidence with respect to any of the proposed opinions due to, *inter alia*, failure to comply with FRE 702, and thus Professor Fischel's testimony should be excluded. The government further requested that, if the district court was inclined to allow any portion of the expert testimony "based on the disclosures to date," the court grant a hearing prior to the admission of the testimony "in order to [permit the government to] challenge its admissibility out of the presence of the jury." Aplt. App. 421 ("taking note of '*Daubert*'s requirement that *some* reliability determination must be made by the trial court *before* the jury is permitted to hear the evidence'" (quoting *Dodge v. Cotter Corp.*, 328 F.3d 1212, 1229 (10th Cir. 2003))). The government additionally requested that in advance of such a hearing, Professor Fischel should provide the reasons and bases of his opinions for the government's review. Aplt. App. 421-22.

Mr. Nacchio filed a seven-page response to the government's motion to exclude the following day.

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[3] Here, as in the parties' briefs and the panel opinion, we use *Daubert* as legal shorthand for the district court's obligation to test a proposed expert's methodology in advance of his or her testimony. *See Daubert*, 509 U.S. at 592-93 (charging trial courts with the responsibility of acting as gatekeepers to ensure that expert testimony is both reliable and relevant); *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 147-49 (1999) (clarifying that the court's gatekeeper function applies to all expert testimony, not just testimony based in science).

Aplt. App. 463. Mr. Nacchio's response asserted that: (1) the revised disclosure complied with Rule 16; (2) Professor Fischel's opinions were proper under FRE 702 and 602; and (3) Professor Fischel was qualified to give the opinions set forth in the "expert report." While Mr. Nacchio did not specifically cite *Daubert* in the FRE 702 discussion—titled "Professor's Opinions Are Proper Under Rule 702"—or use the term "methodology," the response asserted that Professor Fischel would opine on "specialized knowledge as contemplated under Rule 702, which will assist the trier of fact" and that Professor Fischel has undertaken "extensive review" "to formulate opinions that go well beyond 'simple inference.'" Aplt. App. 466.

The next day, Thursday, April 5, trial resumed, and Mr. Nacchio called Professor Fischel to the stand. The district court dismissed the jury, saying, "I need to make some legal rulings at this time." Aplt. App. 3913. Neither party made any statement to the court at that time, and the district court proceeded to rule upon the government's motion to exclude. Observing that "the deficiencies under Daubert and Kumho Tire in these disclosures are so egregious that they hardly warrant the 63 pages of ink the Government has spilled in opposing the testimony," the court then explained why the testimony was "excludable on a number of rationales," including under FRE 702 and *Daubert* and *Kumho Tire*. Aplt. App. 3914-21. Specifically, the court noted its concern with the methodology, "which is absolutely undisclosed in this expert disclosure," and "[m]ost convincingly, the defendant has made no attempt to comply with Rule 702 or Daubert and establish that Fischel's testimony is the product of reliable principles and methods or that Fischel applied

some principles and methods reliably in this case." Aplt. App. 3915, 3917. The court noted that Mr. Nacchio's "only representation on this issue" was one "woefully inadequate" sentence, and it quoted from the sentence noted above regarding the allegedly "extensive review" undertaken by Professor Fischel in formulating his opinions, which was included in Mr. Nacchio's response to the government's motion to exclude. Aplt. App. 3916. The court concluded that "[f]or all of those reasons, primarily the gross defect in failing to reveal the methodology," the government's motion was granted. Aplt. App. 3921.

After the ruling was announced, Mr. Nacchio's attorney asked if he could be heard, and the district court refused his request, saying, "I have your motion,[4] I have the Government's motion, I have your response. Any argument that you wish to make could have been put in the response." Aplt. App. 3921. Mr. Nacchio's attorney then requested and received permission to put Professor Fischel on the stand as a nonexpert witness. The court recessed over Friday and the weekend. Over the weekend, Mr. Nacchio filed a motion requesting, *inter alia*, permission for Professor Fischel to testify as an expert in rebuttal to the testimony of two financial analysts that the government presented as witnesses, or alternatively to strike the testimony of those two analysts.[5] Aplt. App.

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[4] Presumably, the district court was referring to Mr. Nacchio's Rule 16 disclosure, as revised.

[5] Mr. Nacchio filed this motion on Saturday, April 7. Mr. Nacchio then filed an amended, essentially identical motion on Sunday, April 8. Mr. Nacchio requested reconsideration and mentioned a *Daubert* hearing in both the original and the amended motion. The district court discussed but did not rule on Mr.

474. Mr. Nacchio included a footnote requesting reconsideration of the district court's prior exclusion of Professor Fischel's expert testimony and asserting that the district court did not have sufficient evidence nor did it develop a sufficient record to fulfill its *Daubert* gatekeeping function. In this footnote, Mr. Nacchio also suggested for the first time that, while a *Daubert* hearing is not specifically mandated, it would be "particularly appropriate where, as here, the court believes the expert['s] report was insufficiently detailed." Aplt. App. 481 n.4.

On Sunday, April 8, the government filed a motion to exclude the rebuttal testimony, and Mr. Nacchio responded. On Monday, April 9, after Professor Fischel had provided some nonexpert testimony, the district court dismissed the jury and ruled from the bench. The district court denied Mr. Nacchio's motion to permit Professor Fischel's expert rebuttal testimony and to strike the government analysts' testimony, granted the government's motion to exclude Professor Fischel's rebuttal testimony in part, and then dismissed Professor Fischel. In denying Mr. Nacchio's motion, the district court stated that an expert was not necessary to rebut the analysts' opinions, that it "continue[d] to have the same difficulty with this methodology and non-disclosure of the methodology as it had with respect to the original expert report," and that "even if it were reliable, ... the testimony is of no relevancy."[6] Aplt. App. 4075-76.

Nacchio's motion the morning of April 9, before Professor Fischel took the stand to give nonexpert testimony. Aplt. App. 481 n.4, 3969-75, 3980.

[6] The principal dissent highlights this April 9 ruling as further validation for its theory that the district court's April 5 ruling to

exclude Professor Fischel's expert testimony was erroneously predicated solely upon *Daubert* shortcomings in the Rule 16 disclosure. *See* Dissenting Op. at 11-12, 42. The district court's April 9 ruling "is equally susceptible of a correct reading," however. *Sprint/United Mgmt. Co. v. Mendelsohn*, 128 S. Ct. 1140, 1146 (2008). The court's statements are more naturally read as generally explaining that the same lack of reliability that doomed Mr. Nacchio's previous tendering of Professor Fischel as an expert witness continued to plague his proffer of Professor Fischel's testimony as an expert rebuttal witness. In other words, the district court was merely underscoring that neither prior to the latter proffer nor after it had the government or the court been "in possession of Fischel's opinion and/or methodology." Aplt. App. 4075. While the district court allowed that there were "other reasons" for its April 5 decision to exclude Professor Fischel's expert testimony, the court stressed that it was "precisely" that "lack of reliability"—as revealed through *all* of Mr. Nacchio's filings, not just through his March 29, 2007, disclosure—that prompted its exclusion ruling. Aplt. App. 4075.

Mr. Nacchio tacitly acknowledged the legitimacy of the comprehensive decision-making approach that the district court adopted when it considered *all* of Mr. Nacchio's filings with regard to the reliability issue, when Mr. Nacchio himself subsequently took the position that his revised Rule 16 disclosure was part of his submission on Professor Fischel's methodology. *See infra* notes 8, 13, 15. Contrary to the principal dissent's argument, Dissenting Op. at 32-34, we are not suggesting that this acknowledgment by Mr. Nacchio provided the authorization for the district court to follow such a comprehensive gatekeeping approach in excluding Professor Fischel's expert testimony on April 5. The district court did *not* need Mr. Nacchio's "invitation," *id.* at 33, or blessing to take this comprehensive approach. Rather, Mr. Nacchio's subsequent reliance on his revised Rule 16 disclosure as part of his *Daubert* methodology submission simply indicates that even Mr. Nacchio viewed it as legitimate for a district court to consider all "the particular facts and circumstances of the particular case," including Rule 16 disclosures, in assessing whether the requisite *Daubert* methodology showing had been made. *Kumho Tire Co.*, 526 U.S. at 158.

Following the sixteen-day trial, the jury deliberated for six days and convicted Mr. Nacchio on nineteen counts of insider trading covering trades that he had made in April and May 2001. Mr. Nacchio was acquitted of twenty-three counts covering earlier trades.

II. EXPERT TESTIMONY

A. *STANDARD OF REVIEW*

The proponent of expert testimony bears the burden of showing that its proffered expert's testimony is admissible. *Ralston v. Smith & Nephew Richards, Inc.*, 275 F.3d 965, 970 n.4 (10th Cir. 2001). We review de novo "whether the district court employed the proper legal standard and performed its gatekeeper role" in determining whether to admit or exclude expert testimony. *United States v. Rodriguez-Felix*, 450 F.3d 1117, 1122 (10th Cir. 2006). We review for abuse of discretion the manner in which the district court performs this gatekeeping role. *Dodge*, 328 F.3d at 1223 ("Though the district court has discretion in *how* it conducts the gatekeeper function, we have recognized that it has no discretion to avoid performing the gatekeeper function."). Provided the district court performs the role, this Court's review is deferential: we will not disturb the ruling "unless it is arbitrary, capricious, whimsical or manifestly unreasonable," or "we are convinced that the district court made a clear error of judgment or exceeded the bounds of permissible choice in the circumstances." *Id.* (internal quotation marks omitted).

"Under Rule 702, the district court must satisfy itself that the proposed expert testimony is both reliable and relevant, in that it will assist the trier of fact, before permitting a jury to assess such

testimony." *Rodriguez-Felix*, 450 F.3d at 1122. In determining whether expert testimony is admissible, the district court generally must first determine whether the expert is qualified "by knowledge, skill, experience, training, or education" to render an opinion. *See* Fed. R. Evid. 702. Second, if the expert is sufficiently qualified, the court must determine whether the expert's opinion is reliable by assessing the underlying reasoning and methodology, as set forth in *Daubert*. *Rodriguez-Felix*, 450 F.3d at 1123; *see, e.g.*, *103 Investors I, L.P. v. Square D Co.*, 470 F.3d 985, 990 (10th Cir. 2006).

Reliability questions may concern the expert's data, method, or his application of the method to the data. *See Mitchell v. Gencorp Inc.*, 165 F.3d 778, 782 (10th Cir. 1999); *see also* Fed. R. Evid. 702 (noting that the testimony must be "based upon sufficient facts or data" as well as "the product of reliable principles and methods" and the expert must have "applied the principles and methods reliably to the facts of the case"). The party offering the expert "must show that the method employed by the expert ... is scientifically sound and that the opinion is based on facts which satisfy Rule 702's reliability requirements." *Dodge*, 328 F.3d at 1222. "Under *Daubert*, any step that renders the expert's analysis unreliable ... renders the expert's testimony inadmissible. This is true whether the step completely changes a reliable methodology or merely misapplies that methodology." *Mitchell*, 165 F.3d at 782 (alteration in original) (internal quotation marks omitted). In making a reliability determination, "[g]enerally, the district court should focus on an expert's methodology rather than the conclusions it generates." *Dodge*, 328 F.3d at 1222.

B. *Exclusion of Expert Testimony*

1. *The District Court Performed Its Gatekeeping Role*

Although Mr. Nacchio argues that the district court abdicated its gatekeeping function, his argument really concerns the manner in which the district court fulfilled this role, e.g., allegedly failing to ensure the creation of a sufficiently developed record and declining to hold a hearing to reconsider Professor Fischel's admissibility. As discussed below, in its ruling the district court stated and applied the *Daubert* framework—the proper legal standard in determining the admissibility of expert testimony—and it properly performed its role as "gatekeeper" in deciding whether to admit or exclude Professor Fischel's expert testimony. *Compare Rodriguez-Felix*, 450 F.3d at 1125-26 (examining for an abuse of discretion the exclusion of expert testimony on the basis of a report that was insufficient to allow assessment of the reasoning and methodology of the expert as a component of the district court's application of *Daubert*), *and United States v. Turner*, 285 F.3d 909, 912-13 (10th Cir. 2002) (reviewing the denial of a *Daubert* hearing for abuse of discretion), *with United States v. Call*, 129 F.3d 1402, 1405 (10th Cir. 1997) (rejecting the defendant's argument that the district court had applied a per se rule of inadmissibility instead of properly applying *Daubert* when the court had expressly stated and demonstrated that it applied *Daubert*).

Mr. Nacchio argues that the district court's ruling was premised upon Rule 16 and that, consequently, it was patently erroneous. We disagree. The district court's exclusion of Professor Fischel's testimony rested on *Daubert* grounds. True, the government first

framed its challenge to Professor Fischel's expert testimony as an objection to the sufficiency of Mr. Nacchio's Rule 16 disclosure. But, by the time the district court ruled to exclude Professor Fischel's testimony, it was clear that the court's principal concern was *Daubert*. As is evident from its ruling, the district court excluded Professor Fischel's testimony because Mr. Nacchio had not met his burden of demonstrating admissibility as required by FRE 702. For example, after stating that Professor Fischel's testimony could be excluded on a number of grounds, the district court stated: "Most convincingly, the defendant has made no attempt to comply with Rule 702 or Daubert and establish that Fischel's testimony is the product of reliable principles and methods or that Fischel applied some principles and methods reliably in this case." Aplt. App. 3915. Further, the district court stated that "Rule 702 governs this issue." *Id.* This indicates that lack of reliability under FRE 702 was the primary rationale for the court's decision.[7]

Although the district court ruling does include two ambiguous references to "disclosures," when read in context, these references do not indicate that the exclusion was based upon allegedly incorrect Rule 16 grounds or that the district court was referring solely

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[7] The district court's focus on FRE 702 also belies the principal dissent's suggestion that the district court excluded the expert testimony as a sanction for a Rule 16 discovery violation by Mr. Nacchio. *See* Dissenting Op. at 35-38. The cases cited by the principal dissent addressing the scope of a district court's discretion to impose such a sanction are inapposite, as the desire to levy an extreme sanction or penalty was not the impetus for the district court's evidentiary ruling in this case. Put most simply, the impetus for that ruling was Mr. Nacchio's failure to carry his evidentiary burden under *Daubert*.

to Mr. Nacchio's Rule 16 disclosures. "When a district court's language is ambiguous ... it is improper for the court of appeals to presume that the lower court reached an incorrect legal conclusion." *Sprint/United Mgmt. Co.*, 128 S. Ct. at 1146.

First, the district court's enigmatic reference to "these disclosures" occurred in its ruling after the court had outlined the contents of the government's motion to exclude and indicated that it also had read Mr. Nacchio's response to the government's motion. It was from Mr. Nacchio's response to the motion to exclude—rather than from Mr. Nacchio's revised Rule 16 disclosure—that the district court quoted the sentence that it characterized as Mr. Nacchio's "only representation" on the issue of methodology, which the court found to be "woefully inadequate" to support the admissibility of Professor Fischel's testimony. Aplt. App. 3914, 3916. Thus, notwithstanding the "these disclosures" reference, the court's ruling was grounded in *Daubert* and FRE 702 methodology concerns.[8]

Second, although the district court stated that Professor Fischel's methodology was undisclosed "in this expert disclosure," the discussion immediately preceding that comment did not refer to Mr. Nacchio's Rule 16 disclosure. Aplt. App. 3917. Rather, the district court had just quoted from Mr. Nacchio's

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[8] As part of these comments, the district court did note that it also had reviewed Mr. Nacchio's Rule 16 disclosure. However, since Mr. Nacchio (as discussed more specifically *supra* note 6 and *infra* in text and note 15) considered his revised Rule 16 disclosure to be a submission on Professor Fischel's methodology, the district court's consideration of his disclosure is entirely consistent with the idea that the court's principal focus, as well as the foundation for its ruling, was *Daubert* and FRE 702.

argument—made in his response to the motion to exclude—that Professor Fischel's opinions were proper under FRE 702. *Compare* Aplt. App. 3916 *with* Aplt. App. 466.

At most, then, the district court's ruling contains two ambiguous references to "disclosures" that arise in the context of the district court's assessment of Mr. Nacchio's *Daubert* arguments. Although the district court did cite other bases for its ruling, including its doubt that Professor Fischel's testimony was relevant,[9] the decision to exclude Professor Fischel's

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[9] The principal dissent asserts that the district court must have been influenced by its allegedly erroneous conclusion that the excluded evidence was irrelevant and unhelpful. *See* Dissenting Op. at 38-40. However, as the principal dissent acknowledges, review of this relevancy issue was not sought on en banc rehearing, and it is not directly at issue here as explained *infra* in note 21. *See id.* at 39-40; *see also supra* note 1. The panel's holding regarding the district court's relevancy finding—that is, regarding the district court's finding that Professor Fischel's economic evidence was *not* relevant—admittedly did not "disappear," Dissenting Op. at 40, with the grant of the en banc petition. However, in proceedings of this en banc court, that holding has no decisional significance. It is an historical artifact. *See Brown v. Bryan County, OK*, 219 F.3d 450, 453 n.1 (5th Cir. 2000) ("With this vacatur, our previous opinion is no longer the law of the case." (citing *O'Connor v. Donaldson*, 422 U.S. 563, 577 n.12 (1975) ("Of necessity our decision vacating the judgment of the Court of Appeals deprives that court's opinion of precedential effect ...."))). Quite apart from the fact of vacatur, as a matter of logic, the panel's holdings regarding admissibility of Professor Fischel's expert testimony should have no decisional force in this en banc proceeding. It is precisely the panel's work in finding error in the district court's exclusion of Professor Fischel's expert testimony that is open to question here. It logically follows that the panel's work on this point (including its holdings) cannot be permitted to guide the en banc court's assessment of the same general terrain. Even if the outcome here was once again a

expert testimony clearly was premised upon Mr. Nacchio's failure to establish that the testimony was reliable under *Daubert* and FRE 702—a determination that was focused on Professor Fischel's methodology.

We underscore, moreover, that to endorse the assertion that the district court made a ruling

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reversal, it would be the voice of the en banc court speaking, not that of the panel, and the outcome necessarily would be framed in terms of the en banc order and briefing. (Of course, the outcome is not a reversal, and we are expressly vacating the portion of the panel opinion, Part II(A), that addressed the district court's finding regarding the relevance of Professor Fischel's testimony.)

Furthermore, our decision to eschew any reliance on the panel's relevancy holding makes sense as a matter of jurisprudence. As further explained *infra* in note 21, this en banc court vacated the judgment of the panel and agreed to a rehearing on the question of the admissibility of Professor Fischel's expert testimony. That issue is multifaceted, and with great care the en banc court specified the areas for consideration. The en banc court could have included among those areas the district court's findings concerning the relevance of Professor Fischel's economic evidence, but it did not. Rather, the en banc order specified that its grant of rehearing was focused on the issue of Mr. Nacchio's presentation of "evidence in support of the expert's methodology," i.e., the reliability of the testimony. *See supra* note 1. *See generally* 16AA Charles Alan Wright et al., *Federal Practice and Procedure* § 3981.1, at 433 & n.24 (4th ed. 2008) ("[T]he grant of en banc hearing may be limited in advance to an identified issue. ..." (citing cases)). Consequently, the parties have not fully engaged with the en banc court on the relevancy issue in either their briefing or their oral arguments. It would therefore be an odd jurisprudential result indeed (if not a manifestly unfair one) for the en banc court to be guided in its resolution of this appeal by the bygone holdings of the panel, such as its relevancy holding, as to which the parties have not been heard in any meaningful way.

Accordingly, we have properly declined to incorporate such holdings into our analysis; they are not germane. We do not need to reach the relevancy question in our determination of the issue identified for en banc rehearing.

excluding the testimony on allegedly incorrect Rule 16 grounds alone would be particularly problematic in light of the instruction provided by the Supreme Court in *Sprint*. In light of the deference that is "the hallmark of abuse-of-discretion review," we "should not presume that a district court intended an incorrect legal result when the order is equally susceptible of a correct reading." *Sprint*, 128 S. Ct. at 1145, 1146 (internal quotation marks omitted). A fair, natural reading of the district court's decision indicates that the basis for the ruling was *Daubert*. And, the Supreme Court's guidance further demonstrates the impropriety of presuming that the district court based its ruling on purportedly erroneous Rule 16 grounds.

2. ***The District Court's Determination to Exclude the Expert Testimony***

a. Notice

Mr. Nacchio was sufficiently on notice that he was required to present evidence in support of his expert's methodology or request an evidentiary hearing in advance of presenting the expert's testimony. It is well established that, as the proponent of Professor Fischel's expert testimony, Mr. Nacchio bore the burden of establishing its admissibility pursuant to FRE 702. *See Ralston*, 275 F.3d at 970 n.4. This evidentiary burden put Mr. Nacchio on effective notice that, if Professor Fischel's testimony was going to be admitted, it would only be because Mr. Nacchio took appropriate action to get the job done. Mr. Nacchio argues, however, that there is no requirement that admissibility be shown at any specific time before presenting the witness and that he did not have notice of any obligation to proffer additional evidence or request a hearing.

In particular, Mr. Nacchio contends that the presumptive time for establishing the reliability of the expert's testimony is on the witness stand and that he had every right to assume that the court would conduct voir dire or permit the questioning of Professor Fischel before ruling on admissibility.[10] Though Mr. Nacchio's

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[10] In its amicus brief, the National Association of Criminal Defense Lawyers ("NACDL") also asserts that the prevalent practice is to address *Daubert* issues at voir dire. We note this practice only to explain Mr. Nacchio's argument and to expressly recognize that this was *one* of the options that the district court had available to determine admissibility. We need not, and do not, offer any definitive opinion on whether this was the typical—or, using the more loaded language of Mr. Nacchio and the principal dissent, "presumptive," Dissenting Op. at 6—practice in criminal cases for resolving *Daubert* admissibility issues. The principal dissent concedes that the district court was not bound to adhere to this practice, whether or not it was typical or presumptive. *Id.* at 6, 14. It follows that Mr. Nacchio had no entitlement to establish his witness's admissibility on the stand, despite the principal dissent's suggestion to the contrary. Therefore, any discussion by the principal dissent, *id.* at 25-29, about whether Mr. Nacchio's conduct could be deemed to have forfeited such a right is beside the point.

The principal dissent's argument leaves the tracks, moreover, when it suggests that the district court had some obligation to provide specific notice to Mr. Nacchio concerning "*when* and *how* the *Daubert* issue was to be addressed." *Id.* at 18. The principal dissent offers no legal authority that even comes close to establishing its contention that trial courts are obliged to engage in such hand-holding, and we doubt that there is any. Indeed, in preparing to make his Fed. R. Crim. P. 29 motion for judgment of acquittal, Mr. Nacchio demonstrated his understanding of the true state of affairs: that is, it is *a party's* responsibility to seek to dispel any uncertainty concerning the court's practices and procedures. Specifically, Mr. Nacchio's lawyer said to the court, "I am unfamiliar with your practice. May I make an inquiry?" Aplt. App. 3602. Mr. Nacchio's aim was to determine "how extensive a presentation or argument" the court required as to Rule 29

expectation that Professor Fischel's admissibility would be established after he took the stand may have been reasonable, *see, e.g., Goebel v. Denver & Rio Grande W. R.R.*, 215 F.3d 1083, 1087 (10th Cir. 2000), Mr. Nacchio had no entitlement to a particular method of gatekeeping by the district court. Indeed, Mr. Nacchio's purported entitlement is squarely at odds with the directive in *Kumho Tire* that "[t]he trial judge must have considerable leeway in deciding in a particular case how to go about determining whether particular expert testimony is reliable." 526 U.S. at 152. The district court's failure to proceed as Mr. Nacchio anticipated does not by itself constitute an abuse of discretion.[11] *See id.* ("The trial court must

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motions, and the court answered the question. Aplt. App. 3602-03. As with his Rule 29 motion, if Mr. Nacchio was uncertain how the court wished to use its discretion to proceed regarding the admissibility of Professor Fischel's expert testimony and the resolution of the government's motion to exclude, or if he desired a specific method to be followed to assess admissibility, Mr. Nacchio was obliged to voice his query or request to the district court.

[11] The only notice to which Mr. Nacchio was entitled was notice of the fact that the admissibility of his expert witness's testimony had been challenged by a government motion which asked the district court to exclude the testimony. He got that. Once he had responded to that motion and it was thus at issue, Mr. Nacchio had no right to be schooled by the district court concerning the specific means it would use to decide the motion and the timing of its planned action. Moreover, the record suggests that Mr. Nacchio actually should have been on notice that the district court was contemplating ruling on the motion without a hearing. For example, on April 4, the day *before* Professor Fischel was offered as a witness, when the government asked about Professor Fischel, the court stated that it had "formed some preliminary views, but they really haven't jelled to the point" where it was ready to rule on the government's motion to exclude. Aplt. App. 3834. Then, on the morning of April 5, when Professor Fischel's appearance on

have the same kind of latitude in deciding *how* to test an expert's reliability, and to decide whether or when special briefing or other proceedings are needed to investigate reliability, as it enjoys when it decides *whether or not* that expert's relevant testimony is reliable.").

Mr. Nacchio was on notice that the admissibility of Professor Fischel's testimony under FRE 702 was at issue well before the district court issued its ruling.[12]

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the witness stand was *not* imminent, the district court raised the topic of the motion to exclude and said to the government, "I know that I have the motion on the expert testimony, but we're already a half hour overdue with the jury, and I know you want a ruling." Aplt. App. 3870. The court's comments reasonably can be read as indicating that the court contemplated ruling on the admissibility of Professor Fischel's expert testimony *before* he took the stand, believed that the parties expected it to do so, and was acknowledging that the court had been somewhat tardy in providing that ruling. Therefore, in fact, Mr. Nacchio arguably should have been on notice that the *Daubert* admissibility issue concerning Professor Fischel's testimony probably would *not* be resolved through his testimony on the stand, *unless* Mr. Nacchio, as the proponent of that testimony, took affirmative measures to secure the use of that procedure from the district court—something that Mr. Nacchio, of course, did not do. In any event, the principal dissent's argument that Mr. Nacchio was entitled to notice from the district court of the means it would use to resolve the government's at-issue motion to exclude and the timing of its planned action, and that Mr. Nacchio therefore could rightly claim unfair surprise when he did not get such notice, is legally untenable.

[12] Mr. Nacchio himself had cited *Daubert* repeatedly, and expressly requested "a hearing, mandated by *Daubert*, prior to trial" "to test the admissibility of" testimony from certain high-level Qwest executives who were expected to be government witnesses, whom Mr. Nacchio argued would offer expert testimony. Dist. Ct. Doc. 64, at 1, 2, 3-5, 8-9 (Def.'s Mot. to Compel, filed May 1, 2006); Dist. Ct. Doc. 103, at 2, 7, 8 (Def.'s

As early as the government's motion regarding the first Rule 16 disclosure, the government argued that FRE 702 was implicated. Aplee. Supp. App. 39. Furthermore, the March 22nd in-court oral exchange that raised the possibility of *Daubert* issues arising—in which Mr. Nacchio's counsel noted that "forewarned is forearmed"—was, at the very least, de facto warning of the imminent need for Mr. Nacchio to meet his burden. *Cf. Macsenti v. Becker*, 237 F.3d 1223, 1231-32 (10th Cir. 2001) (noting that even when a party does not timely raise a *Daubert* objection, "the trial judge is assigned the task of insuring that an expert's testimony rests on a reliable foundation and is relevant, but *Daubert* does not mandate an inquiry questioning and challenging the scientific proffer absent a timely request by an objecting party").

Even if nothing previously had alerted Mr. Nacchio to the burgeoning *Daubert* issue, the government's motion to exclude Professor Fischel's expert testimony invoked *Daubert* and FRE 702 numerous times. The motion was based on deficiencies in the Rule 16 disclosure *and* on Mr. Nacchio's failure to carry his burden to demonstrate that Professor Fischel's testimony was admissible. The government's motion explicitly set forth authority and analysis regarding FRE 702's mandate that the expert testimony be "the product of reliable principles and methods," and it offered detailed reasons why those specific opinions did

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Reply to Gov't's Resp. to Mot. to Compel, filed June 22, 2006); Aplt. App. 220. Mr. Nacchio again cited *Daubert* in (successfully) seeking to exclude the testimony of two of the government's computer experts. Aplee. Supp. App. 14. These repeated and salient references to *Daubert* by Mr. Nacchio severely undercut any argument that Mr. Nacchio would not recognize the *Daubert* challenge being raised in the government's motion to exclude.

not meet this methodology requirement. Aplt. App. 374-78, 385, 388, 390, 396, 407-08, 415.

Furthermore, there can be no question, given the explicit language and tenor of Mr. Nacchio's response to this motion, that he understood that *Daubert* issues had arisen. Therefore, he also should have understood that, if the time had not earlier been ripe to bear the admissibility burden, that time had arrived.[13] Specifically, when Mr. Nacchio responded, in substance, he addressed *Daubert* issues in discussing FRE 702 and Professor Fischel's qualifications. Although the precise word *Daubert* was not invoked, a section heading in his response was "Professor's Opinions Are Proper Under Rule 702." In that section, Mr. Nacchio discussed the "specialized knowledge" that Professor Fischel purportedly would bring to the jury

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[13] In other words, at this point Mr. Nacchio's decision to steadfastly continue to view the government's attack on Professor Fischel's expert testimony solely as it was initially framed—that is, only through the lens of Rule 16—became both unwise and perilous. Similarly, though the principal dissent emphasizes that a Rule 16 disclosure does not need to include the information sufficient to make a *Daubert* determination, *see* Dissenting Op. at 12-13, that contention is premised upon the assumption that this Rule 16 analytical lens continued to be applicable up until the time the district court issued its exclusion ruling. As explained above in the text, however, despite Mr. Nacchio's desire to adhere to this standpoint—which he did to the exclusion of adequately turning his attention to the FRE 702 issue—Rule 16 did not principally govern the terms of the debate once he had received notice that Professor Fischel's methodology was controverted. The risk of not sufficiently rising to the government's FRE 702 challenge and of not setting forth all available arguments for the testimony's admissibility in fact materialized for Mr. Nacchio when the district court acted within its discretion to exclude the testimony under *Daubert*.

and the analytic approach toward the financial data that he had undertaken to "formulate opinions," i.e., his methodology. Aplt. App. 466. Thus, as of April 4, when he filed his response, Mr. Nacchio was not only on notice that *Daubert* was in play, he had affirmatively responded to the *Daubert* issues.

Mr. Nacchio is attempting to recast an unremarkable district court evidentiary ruling as an invidious act of judicial hubris. But it will not work. At bottom, Mr. Nacchio's argument is no more than a run-of-the-mill lament of unfair surprise. We have rejected similar claims when, as here, the record belies them.

For example, in *Ralston*, we concluded that the record did not support plaintiff's claim that she was unfairly surprised by the district court's decision at a summary judgment hearing to exclude her expert's testimony under FRE 702. 275 F.3d at 970 n.4. The district court found that the expert was unqualified to render an opinion in support of plaintiff's liability theory. *Id.* at 968. We noted that in the defendant's written response to plaintiff's summary judgment filing "an entire section is devoted to the argument that [plaintiff's expert] was not qualified to render an expert opinion." *Id.* at 970 n.4. And we commented further: "As the purpose of the hearing was to discuss the issues raised in the parties' supplemental summary judgment papers, it is *disingenuous* for Plaintiff to now claim that she was unaware that [her expert's] qualifications would be at issue at the hearing." *Id.* (emphasis added). Therefore, we rejected plaintiff's claim of unfair surprise.

The reasoning of *Ralston* applies with even greater force on these facts. As in *Ralston*, before the district court acted to exclude it, the opponent of the expert

testimony—the government—specifically challenged the admissibility of the expert testimony in its briefing and detailed the legal bases for its exclusion (e.g., methodology deficiencies under *Daubert*). In its motion to exclude Professor Fischel's testimony, the government referred to *Daubert* and FRE 702 numerous times in pointing out alleged deficiencies in Professor Fischel's testimony. By way of notice, however, Mr. Nacchio got more than the *Ralston* plaintiff. Among other things, he received the de facto warning of possible *Daubert* issues associated with Professor Fischel's testimony arising from the March 22nd oral exchange with the government and the district court. Accordingly, under *Ralston*'s logic, we find unpersuasive (if not disingenuous) Mr. Nacchio's argument that he did not have notice, before the district court ruled against him, that the admissibility of Professor Fischel's testimony under *Daubert* was at issue.[14] *Cf. Starter Corp. v. Converse, Inc.*, 170 F.3d

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[14] In an unpublished decision where the *Daubert* issue was in high relief, *Solorio v. United States*, we followed *Ralston*'s logic in rejecting a claim by plaintiffs of unfair surprise. 85 F. App'x 705, 709-10 (10th Cir. 2004). We recognize of course that *Solorio* is not binding precedent; however, given its factual similarity, we find its reasoning especially persuasive. There, plaintiffs contended that they did not receive adequate notice of the *Daubert* challenge to their expert and that the district court issued its ruling on an incomplete record. *Id.* It apparently was undisputed that the government defendant had not filed "a separate motion to exclude [the] evidence" and the exclusion was not preceded by "an explicitly-noticed *Daubert* hearing." *Id.* at 709. Nonetheless, we determined that plaintiffs' claim was untenable and that the district court did not abuse its discretion in excluding the expert's testimony following a summary judgment hearing in which the testimony's admissibility was litigated. *Id.* at 710. We noted that the government had expressly presented a *Daubert* attack in its

286, 299 (2d Cir. 1999) (finding no abuse of discretion when district court granted injunctive relief to defendant sua sponte without a formal hearing when plaintiff had both notice of the court's intention and the opportunity to address the issue through its briefs).

On the other hand, our decision in *Procter & Gamble Co. v. Haugen* illustrates well the rare set of circumstances—not found here—in which a proponent

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reply brief for its motion for summary judgment. Furthermore, the government had suggested at the summary judgment hearing that a pretrial *Daubert* hearing be held, but plaintiffs did not second the proposal. *Id.* at 708-10. Under these circumstances, we concluded that "[i]n spite of receiving notice and an opportunity to be heard, [plaintiffs] failed to make an adequate showing on the *Daubert* gatekeeping issue," and, consequently, it was not an abuse of discretion for the district court to exclude their expert. *Id.* at 710. In other words, based upon the record, we determined that "plaintiffs' assertion of unfair surprise r[ang] hollow." *Id.* We should perforce adopt the same view here. Mr. Nacchio received as much notice as *Solorio*'s plaintiffs—and then some. As with those plaintiffs, Mr. Nacchio was clearly alerted to the idea that the admissibility under *Daubert* of his expert's testimony was under attack when the opponent of the testimony (i.e., the government) advanced detailed written legal arguments under *Daubert* for its exclusion and raised the possibility of a *Daubert* hearing. But, like *Solorio*'s plaintiffs, Mr. Nacchio unwisely did not second the idea of a hearing, or otherwise meaningfully rise to the challenge, presented by the government's written arguments, of defending the admissibility of his expert's testimony. Furthermore, Mr. Nacchio actually got more notice than did the *Solorio* plaintiffs. Most notably, unlike them, Mr. Nacchio *did* receive from the government a separate motion to exclude his expert's testimony. In other words, there was no reasonable possibility that Mr. Nacchio could have been left in the dark concerning the government's intentions; the sole purpose of its motion was to exclude the testimony of his expert. Therefore, even more emphatically here than in *Solorio*, we are justified in concluding that Mr. Nacchio's claim of unfair surprise rings hollow.

of expert testimony had so little notice of the district court's impending exclusion of its expert testimony that a claim of unfair surprise would have been justified. 427 F.3d 727, 736-37, 742 (10th Cir. 2005). In that case, the district court dismissed with prejudice the plaintiffs' Lanham Act claims following a hearing on a motion for discovery sanctions against the plaintiffs. *Id.* at 736-37. The dismissal was partly based on the court's finding that the plaintiffs' expert testimony on damages was inadmissible. *Id.* at 737. The admissibility ruling was only a paragraph, and the entire rationale was that the expert's damages testimony was not admissible under FRE 702 and *Daubert* because the testimony was based on an examination of too few products. The district court found that "[s]uch testimony clearly would not be based upon sufficient facts or data to be admissible in this Court" and without damages evidence the plaintiffs' claims must fail. *See id.*

Observing that the district court doubtless would have had to determine the admissibility of the expert testimony "at some point," we concluded that this basis did not justify dismissal of the case. *Id.* at 742. We noted that there were two major problems with the district court's ruling that the expert's testimony was inadmissible. First, the plaintiffs "had absolutely no warning prior to the district court's order of dismissal that the district court would be considering, let alone ruling on, the admissibility of [their expert's] testimony." *Id.* Second, "[u]ndoubtedly due to the lack of prior notice, neither side ... provided the district court with detailed briefing regarding the admissibility of [the plaintiffs'] expert's testimony"; in turn, the district court record lacked specific findings as to why

it concluded the testimony was inadmissible. *Id.* Thus, the circumstances strongly suggested that the district court had "'simply made an off-the-cuff decision to [exclude] the expert testimony.'" *Id.* (alteration in original) (quoting *Dodge*, 328 F.3d at 1223). Accordingly, we determined that the district court abused its discretion in excluding the expert's testimony.

Procter & Gamble Co. starkly reveals the weaknesses of Mr. Nacchio's claim of unfair surprise. There, admissibility of the plaintiffs' expert testimony had not been the subject of any filings or discussion, and the proponents "had not submitted any expert reports to the district court, the district court had not heard any expert testimony, and no motion to limit or exclude [the plaintiffs'] expert was before the court." *Id.* at 741. By contrast, the expert admissibility issue here had been put before Mr. Nacchio multiple times, and the district court's ruling offered specific support for its determination and referenced relevant filings by both Mr. Nacchio and the government. In short, Mr. Nacchio's claim of unfair surprise is woefully deficient and does not provide a basis for us to conclude that the district court abused its discretion in excluding Professor Fischel's testimony.

b. Opportunity

Mr. Nacchio had an adequate opportunity to present evidence in support of Professor Fischel's methodology or to request an evidentiary hearing in advance of presenting the expert's testimony. In addition to a continuous opportunity to file a written proffer of evidence, or to file a request for a hearing or a continuance, there were several specific instances, arising *after* the *Daubert* issue had come into focus,

where Mr. Nacchio could have presented evidence or requested a hearing to meet his burden of admissibility:

- Initially, in his response to the government's April 3rd motion to exclude Professor Fischel's expert testimony—through which Mr. Nacchio certainly was apprised of the extant *Daubert* issue—Mr. Nacchio could have addressed the *Daubert* issue more thoroughly, offered substantially more methodology evidence, or requested a hearing or a continuance. Instead, Mr. Nacchio set forth only a few sentences regarding the propriety of Professor Fischel's opinions under FRE 702.[15] Aplt. App. 466.
- During the trial's lunch recess on Wednesday, April 4, the court spoke with the attorneys and noted that Mr. Nacchio had filed a response to the government's pending motion to exclude, but Mr. Nacchio did not make any requests regarding Professor Fischel. Aplt. App. 3721-23.
- At the close of the government's case on April 4, the court heard Mr. Nacchio's motion for acquittal and discussed various matters with the attorneys. When *the government* asked about Professor Fischel, the court stated that it had "formed some preliminary views" but was not yet ready to rule. Beyond noting that Professor Fischel would be the

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[15] As discussed below, Mr. Nacchio also considered his revised Rule 16 disclosure to be a submission on Professor Fischel's methodology. Aplee. Supp. En Banc App. 50. Mr. Nacchio's assertion that he lacked notice and opportunity to establish reliability is undercut by his simultaneous assertion that he submitted methodology evidence (i.e., evidence concerning reliability) to the district court.

third defense witness, Mr. Nacchio did not offer any more information to the court. Aplt. App. 3834-35.

- The morning of Thursday, April 5, the court discussed pending motions and ruled on five of them. When the court mentioned the motion to exclude Professor Fischel's expert testimony ("I know you want a ruling"), Mr. Nacchio said nothing, and was silent regarding the matter while the first two defense witnesses testified. Aplt. App. 3870.
- Although Mr. Nacchio argues that the ruling was issued before either party could say anything to the court, prior to calling Professor Fischel to the stand on April 5, Mr. Nacchio had the opportunity to, but did not, request time for argument, a hearing, or a continuance. When Professor Fischel was called, the court immediately announced that it needed to make some legal rulings and dismissed the jury. Aplt. App. 3913.

Mr. Nacchio asserts that the district court's refusal to allow him to orally argue Professor Fischel's admissibility was unfair on account of the court's earlier statement that "I'm not criticizing anybody for not submitting things in writing." Aplt. App. 3603. For two reasons, however, this argument is unavailing. First, the district court appears to have made this statement *not* as a general instruction to be applied wholesale throughout the trial, but in response to Mr. Nacchio's specific inquiry as to the court's preferred practice for entertaining a Fed. R. Crim. P. 29 motion for a judgment of acquittal. *See id.* ("Normally, *it's* done orally, and *it's* certainly appropriate in this case." (emphasis added)). Second, there is no evidence that the district court refused to hear Mr. Nacchio's admissibility argument *because* it was made orally;

rather, the district court denied Mr. Nacchio yet another opportunity to set forth a basis for admission because this argument could have been presented—no matter the format—*before* the ruling was made, particularly in response to the government's motion to exclude. The district court's ruling was not a penalty or a punishment;[16] rather, the exclusion was the obligatory result of Mr. Nacchio's failure to meet his requisite burden under FRE 702 despite serial opportunities to do so.

While it would be an abuse of discretion for the district court to unreasonably limit the evidence upon which it based its *Daubert* decision, *see Dodge*, 328 F.3d at 1228, that did not happen here. There is no evidence that the district court had imposed filing restrictions or had otherwise prohibited Mr. Nacchio from offering evidence or making a request. *Cf. id.* at 1223-24, 1229 (concluding that in a case "where the expert testimony is crucial to the ultimate outcome, is vigorously challenged, and has several obvious areas of concern," it was unreasonable for the court to severely limit the

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[16] More specifically, the district court did not exclude Professor Fischel's expert testimony as a penalty for Mr. Nacchio's failure to request a *Daubert* hearing or to second the government's suggestion of such a hearing in his response to the government's motion to exclude. The district court's ruling resulted instead from Mr. Nacchio's failure to meet the evidentiary challenge put forth by the government by any of the legal means available to him. If Mr. Nacchio felt that he could not adequately respond to the motion to exclude with his written response, it was incumbent upon him to request whatever additional proceedings he thought necessary to achieve his evidentiary objective. After he failed to do so, the district court made its ruling on the basis of the record that *had* been developed, which was fully adequate for the court to examine the reliability issue as we discuss in Part II(B)(2)(d).

filing of underlying documentation, decline to accept proffers, and to otherwise circumscribe the information upon which it based its decision); *see also In re Paoli R.R. Yard PCB Litig.*, 916 F.2d 829, 854 & n.30 (3d Cir. 1990). Mr. Nacchio made no mention of a *Daubert* hearing to the district court until he inserted the footnote in his motion filed *after* the court issued its ruling excluding Professor Fischel's expert testimony. Even in this footnote, Mr. Nacchio fails to address the key concern that the district court previously had highlighted in excluding Professor Fischel's testimony—his methodology for this particular case.

Mr. Nacchio asserts that he lacked pre-ruling opportunity to present evidence or request a hearing because he had been under tremendous time pressure. Any purported lack of time to prepare a response must be considered in the context of months of trial and witness preparation that both parties had undertaken. Although Mr. Nacchio may have been on a tight deadline, a request for a continuance or a *Daubert* hearing, prior to calling Professor Fischel to the stand, would have been rather simple to undertake and certainly would not have required much time at all. The district court, having been alerted to the need for a ruling on admissibility and having given the parties an opportunity to present their arguments, was obligated to perform its gatekeeping function. *See Macsenti*, 237 F.3d at 1233-34; *Goebel*, 215 F.3d at 1088. Therefore, it should have come as no surprise to Mr. Nacchio that the district court ruled on admissibility; indeed, by waiting to rule until Professor Fischel actually was called, it had prolonged the opportunity for Mr. Nacchio to further address the *Daubert* challenge until such a ruling was compelled by Professor Fischel's

imminent testimony. Instead, after "the district judge made clear his need for some proffer of data or literature underlying the expert's assumptions and conclusions, ... the defense offered practically nothing, despite repeated opportunities to do so." *United States v. Brien*, 59 F.3d 274, 277 (1st Cir. 1995).

c. Burden

If Mr. Nacchio desired an evidentiary hearing, he bore the burden of requesting one. As explained below, Tenth Circuit case law does not mandate that a hearing be held, and neither the government nor the district court was under any obligation to call for a hearing or to prod Mr. Nacchio to supplement his filings. According to Mr. Nacchio, the only directive he had received from the district court was to comply with Rule 16, and he read the court's order for a revised Rule 16 disclosure at face value. Even assuming that this was a natural reading of the court's order, however, the proponent's burden of establishing admissibility of expert testimony arises from the offering of the expert for trial; it is not triggered by a court's directive. *See* Fed. R. Evid. 702 advisory committee's note (2000) ("[T]he admissibility of all expert testimony is governed by the principles of [Fed. R. Evid.] 104(a). Under that Rule, the proponent has the burden of establishing that the pertinent admissibility requirements are met by a preponderance of the evidence.").

Relatedly, as discussed above, the government's motion to exclude clearly set forth the FRE 702 issue, regardless of whether the parties' previous communications had taken place in a Rule 16 context. In ordinary motion practice, a respondent must address any and all issues raised by a moving party's

papers, or else face the very real possibility that it will be deemed to have abandoned its right to do so.[17] *See,*

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[17] We use the term "abandoned" here only to explain how Mr. Nacchio necessarily lost his opportunity to mount a response to the government's challenge to the admissibility of Professor Fischel's testimony on any grounds that he failed to present *before the district court ruled.* The principal dissent repeatedly suggests that we have predicated our analysis on the view that Mr. Nacchio forfeited his right to present testimony to establish the admissibility of Professor Fischel's expert testimony by failing to request a hearing, most notably in Mr. Nacchio's response to the government's motion to exclude. *See* Dissenting Op. at 6-7, 25-29, 44. Not true. Mr. Nacchio did not forfeit any rights, because he did not fail to assert any rights. *See United States v. Olano*, 507 U.S. 725, 733 (1993) ("[F]orfeiture is the failure to make the timely assertion of a right ...."). Likewise, Mr. Nacchio did not forfeit his defense of the admissibility of the expert testimony. *See Eberhart v. United States*, 546 U.S. 12, 19 (2005) (noting that when the government failed to raise a timely defense "it forfeited that defense"). Rather, Mr. Nacchio affirmatively engaged in the dispute and defended his witness's admissibility, e.g., responding to the government's motion, but he did so ineffectively and, more specifically, not well enough to satisfy the district court that the expert testimony was admissible. First, contrary to the principal dissent's assertion, *see* Dissenting Op. at 29, Mr. Nacchio did not respond *fully* to the government's thorough motion, which had challenged the admissibility of the expert testimony in extensive detail. The district court reasonably could find that Mr. Nacchio's skeletal response—touching on Professor Fischel's methodology with one "woefully inadequate" sentence—was just not good enough, even when combined with the other information it had received about Professor Fischel's proposed testimony. Aplt. App. 3916. Second, Mr. Nacchio did not timely take affirmative steps to seek whatever additional procedures he deemed necessary to contradict the government's motion, such as requesting a chance to establish admissibility when Professor Fischel took the stand. Before the district court ruled, as discussed *supra* in text, Mr. Nacchio had numerous and continual opportunities to present arguments to enhance his chances of securing a favorable ruling on admissibility—not just in his

e.g., *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146-47 (1997) (finding no abuse of discretion in district court's exclusion of expert testimony when the proponent's response was nonresponsive to the critique of the opponent, even though the district court did not hold oral argument); *In re Rezulin Prods. Liab. Litig.*, 224 F.R.D. 346, 352 (S.D.N.Y. 2004) ("It would be inappropriate to permit litigants to take it upon themselves to litigate issues in whatever piecemeal fashion they wish, trying out one argument and then, if unsuccessful, starting all over again with a new one.... Plaintiffs' obligation was to make their complete argument ... and then to abide the result."); *cf. Feinstein v. Resolution Trust Corp.*, 942 F.2d 34, 43-44

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written response to the government's motion to exclude, but also in oral arguments to the court, or in a full-blown *Daubert* hearing (had he requested one). Thus, it is not a question of omission or an overall failure to act, amounting to a forfeiture; there was, instead, a failed attempt by Mr. Nacchio to establish admissibility.

We simply recognize that the district court properly exercised its discretion under *Daubert* in finding that Mr. Nacchio had failed to carry his evidentiary burden and that Professor Fischel's expert testimony was inadmissible. In other words, the government presented a *Daubert* challenge, and though Mr. Nacchio actively participated he did not respond effectively—he did not squarely and sufficiently oppose that challenge. The district court was legally obligated to decide whether admissibility had been established. *See, e.g.*, *Dodge*, 328 F.3d at 1223 (noting that the district court "has no discretion to avoid performing the gatekeeper function"). And Mr. Nacchio simply lost the contest over admissibility, which is fully contemplated by our adversary system of justice. No question of forfeiture or waiver, as those concepts are customarily understood, *see United States v. Zubia-Torres*, 550 F.3d 1202, 1205-07 (10th Cir. 2008) (McConnell, J.), has any bearing on our recognition of the propriety of the district court's discretionary decision to exclude Professor Fischel's expert testimony.

(1st Cir. 1991) ("In this case, there is no sound reason to overlook the usual rules of pleading and practice and relieve the appellants from their seemingly deliberate choice to stand or fall upon their complaint as pleaded.... [W]e are not so foolhardy as to require district judges to act as mind readers [regarding plaintiffs' desire to amend their complaint]."). Courts are not disposed to allow litigants to have two or more bites at the proverbial apple. *See, e.g., EEOC v. Westinghouse Elec. Corp.*, 925 F.2d 619, 631 & n.20 (3d Cir. 1991) ("A remand should not be ordered when 'two bites of the apple' would be given to a litigant who, under circumstances such as those at bar, has neglected to produce evidence to support a desired finding and has, therefore, failed to carry its requisite burden as to a particular issue."); *cf. Weisgram v. Marley Co.*, 528 U.S. 440, 455 (2000) ("It is implausible to suggest, post-*Daubert*, that parties will initially present less than their best expert evidence in the expectation of a second chance should their first try fail.").

Thus, having been placed on notice by the government's motion to exclude that the admissibility of Professor Fischel's testimony under FRE 702 was at issue, Mr. Nacchio—in addition to addressing any Rule 16 concerns—was obliged to marshal his FRE 702 arguments that would support admission of Professor Fischel's testimony. Our adversary system of justice simply does not afford a respondent, like Mr. Nacchio, the luxury of ignoring the ebb and flow of litigation and steadfastly adhering to the initial framing of the issues. *Cf. Lujan v. Nat'l Wildlife Fed'n*, 497 U.S. 871, 897 (1990) ("[A] litigant's failure to buttress its position

because of confidence in the strength of that position is always indulged in at the litigant's own risk.").

That conclusion, moreover, is not enervated by the criminal nature of the proceedings. Like civil parties, criminal defendants must follow the well-settled rules of litigation. *See, e.g.*, *Chambers v. Mississippi*, 410 U.S. 284, 302 (1973) ("Few rights are more fundamental than that of an accused to present witnesses in his own defense. In the exercise of this right, the accused, as is required of the State, must comply with established rules of procedure and evidence designed to assure both fairness and reliability in the ascertainment of guilt and innocence." (citations omitted)); *United States v. Barajas-Chavez*, 358 F.3d 1263, 1266 (10th Cir. 2004) ("A defendant must raise a motion to suppress evidence before trial or that objection is waived.").

Mr. Nacchio also asserts that he had no reason to request a hearing, because the government already had done so. However, Mr. Nacchio's response to the motion to exclude—which stated that the motion was "without merit" and should be denied, without itself requesting additional proceedings—plausibly could be read as both opposing the government's hearing request and inviting the court to rule on admissibility without further proceedings. Aplt. App. 463, 468. Furthermore, Mr. Nacchio was on notice that if he desired an evidentiary hearing to be held during these proceedings, he needed to request one. Specifically, the district court judge's published practice standards, of which Mr. Nacchio was aware, *see* Aplee. Supp. En Banc App. 63, provided that any party opposing a motion must state to the court whether that party believes an evidentiary hearing is necessary and

estimate the length of such a hearing. Aplee. Supp. Br. Add. ¶ 17, at 8.

As conceded by Mr. Nacchio in his belated mention of a hearing to the district court, *see* Aplt. App. 481 n.4, Tenth Circuit cases have interpreted *Kumho Tire*'s directive that courts must have leeway in applying the *Daubert* framework to mean that although *Daubert* hearings are the most common way to fulfil the gatekeeper function, "'such a process is not specifically mandated.'" *See Turner*, 285 F.3d at 913 (quoting *Goebel*, 215 F.3d at 1087); *accord Dodge*, 328 F.3d at 1228; *United States v. Nichols*, 169 F.3d 1255, 1263 (10th Cir. 1999); *Call*, 129 F.3d at 1405.[18] Therefore, if Mr. Nacchio was not satisfied with the district court's failure to address the government's request for a hearing, the burden of requesting one fell to him. *Cf. Greenlaw v. United States*, 128 S. Ct. 2559, 2564 (2008) ("[O]ur adversary system is designed around the premise that the parties know what is best for them, and are responsible for advancing the facts and arguments entitling them to relief." (internal quotation marks omitted)).

Mr. Nacchio argues that he had no burden to request a hearing, in light of our case, *United States v.*

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[18] Other circuits are in accord with the Tenth Circuit view. *See, e.g., Cook ex rel. Estate of Tessier v. Sheriff of Monroe County, Fla.*, 402 F.3d 1092, 1113-14 (11th Cir. 2005); *Mukhtar v. Cal. State Univ., Hayward*, 299 F.3d 1053, 1064 (9th Cir. 2002), *amended*, 319 F.3d 1073 (9th Cir. 2003); *United States v. Evans*, 272 F.3d 1069, 1094 (8th Cir. 2001); *Nelson v. Tenn. Gas Pipeline Co.*, 243 F.3d 244, 248-49 (6th Cir. 2001); *In re TMI Litig.*, 199 F.3d 158, 159 (3d Cir. 2000), *amending* 193 F.3d 613 (3d Cir. 1999).

Roberts,[19] as well as some Third Circuit decisions, which he cites for the proposition that district courts err when they exclude expert testimony without conducting a hearing, when the record is inadequate to allow for a proper reliability determination. Mr. Nacchio's argument is contrary, however, to the case law of this and other circuits. And his cited cases do not stand for the proposition that the burden was on the district court, rather than on him, to initiate an evidentiary hearing on the *Daubert* issue.

More specifically, as to *Roberts*, Mr. Nacchio contends that the case indicates that "the improper exclusion of Fischel requires reversal regardless of whether Nacchio provided sufficient information to establish admissibility before the court's *in limine* ruling." Aplt. Supp. Br. 29. In *Roberts*, a tribal official was indicted on sexual abuse charges based on the allegations of three women. 88 F.3d at 875. The government sought to introduce under FRE 404(b) evidence of the defendant's sexual abuse of nine other women not named in the indictment. *Id.* at 879. As part of its FRE 404(b) analysis, *see, e.g.*, *United States v. Parker*, 553 F.3d 1309, 1313-14 (10th Cir. 2009), the district court excluded the evidence under FRE 403 on the ground that its potential prejudice substantially outweighed its probative value. *Roberts*, 88 F.3d at 879. The government appealed, and this Court reversed and ordered a pretrial hearing. *Id.* at 881. We concluded that the district court failed to analyze the evidence in sufficient detail to determine whether

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[19] 88 F.3d 872 (10th Cir. 1996), *superseded by statute on other grounds*, Omnibus Consolidated Appropriations Act of 1997, Pub. L. No. 104-208, 110 Stat. 3009-25, *as recognized in United States v. Meacham*, 115 F.3d 1488, 1491 (10th Cir. 1997).

it would demonstrate that the defendant engaged in a common scheme of sexual abuse—"the government's strongest rationale for introducing this evidence at trial." *Id.* at 880-81. We further determined that the government needed to submit additional information about the women's proposed testimony on remand, because the record was insufficient to determine whether the testimony would sustain the common scheme hypothesis. *Id.* at 881.

Roberts should not be interpreted, however, as having placed the burden on the district court here to order a hearing, for two principal reasons. First, in *Roberts*, we emphasized that our ruling rested upon "the unique and specific circumstances present" before us, and we did not purport to extend our holding beyond the Rule 404(b) context. *Id.* Indeed, we recognized that even in that context our holding would have limited application: "[T]his holding does not portend a requirement that district courts conduct similar hearings in all Fed.R.Evid. 404(b) cases involving the government's attempt to establish the defendant's common scheme or plan. The nature of the evidence relied upon by the prosecution will dictate how the issue must be resolved." *Id.*

Second, the *Roberts* holding primarily was based on the district court's failure to appropriately analyze the proposed testimony, not the insufficiency of the information submitted by the proponent (i.e., the government). The instruction that the government must submit more information was a secondary consideration to the remand that was required due to the district court's failure to direct enough attention to the evidence of the government's salient theory of relief (i.e., common scheme or plan). *See id.* at 880-81;

see also United States v. Roberts, 185 F.3d 1125, 1142 (10th Cir. 1999) ("We believe the district court followed our remand order and decided correctly ... the six women's testimony was admissible to show a common scheme.").

As for the Third Circuit case law, Mr. Nacchio relies heavily on *Padillas v. Stork-Gamco, Inc.*, 186 F.3d 412 (3d Cir. 1999). To the extent that *Padillas* should be looked to as persuasive authority, however, it does not mandate a hearing in every instance of *Daubert* gatekeeping. In *Padillas*, the Third Circuit reversed a grant of summary judgment premised upon the inadmissibility of an expert's report under *Daubert* and ordered an evidentiary hearing. In that case, the appellate court stated that "plaintiff could not have known in advance the direction the district court's opinion might take and thus needed an opportunity to be heard on the critical issues before having his case dismissed." *Id.* at 417-18.

The *Padillas* court emphasized that the district court had not offered plaintiff sufficient process to defend the admission of the expert testimony and that the district court's rejection of the testimony did not establish that there were not "good grounds" for the testimony, but, rather, that the opinions were insufficiently explained and their foundations inadequately explicated. *Id.* at 418. Thus, *Padillas* is readily distinguishable from this case, in that: (1) Mr. Nacchio knew the court would have to determine Professor Fischel's admissibility, given that the government's motion to exclude was ripe for decision and Mr. Nacchio actually called Professor Fischel to the stand; and (2) as explained above, Mr. Nacchio passed over numerous opportunities to defend

admissibility and provide more information about methodology. In fact, *Padillas* is most closely analogous to our decision in *Procter & Gamble Co.*, 427 F.3d at 742, which, as discussed above, involved circumstances that sharply contrast with those here. *See supra* Part II(B)(2)(a). Moreover, the language of *Padillas* itself does not mandate a hearing under the instant circumstances:

> An in limine hearing will obviously not be required whenever a *Daubert* objection is raised to a proffer of expert evidence. Whether to hold one rests in the sound discretion of the district court. But when the ruling on admissibility turns on factual issues, as it does here, *at least in the summary judgment context*, failure to hold such a hearing *may be* an abuse of discretion. We hold that *in this case*, it was.

Padillas, 186 F.3d at 418 (emphasis added). As evident by the underscored text, *Padillas* narrowly tailored its holding to the summary judgment context and the factual circumstances of the case before it. Thus, Mr. Nacchio's argument that *Padillas* required the district court during the course of this criminal trial to sua sponte order an evidentiary hearing fails.

Furthermore, more recent decisions from the Third Circuit have rejected the notion that a hearing is always required for *Daubert* gatekeeping. As the Third Circuit stated in *In re TMI Litigation*: "We did not intend to suggest [in *Padillas*] that an *in limine* hearing is always required for *Daubert* gatekeeping." 199 F.3d at 159. Further, "*Padillas* certainly does not establish that a District Court must provide a plaintiff with an open-ended and never-ending opportunity to meet a *Daubert* challenge until plaintiff 'gets it right.'"

Id.; *accord Oddi v. Ford Motor Co.*, 234 F.3d 136, 151-55 (3d Cir. 2000); *Nelson*, 243 F.3d at 249 n.3.

Therefore, neither *Roberts* nor holdings from the Third Circuit lift the burden of requesting a hearing from Mr. Nacchio.

d. No Abuse of Discretion

The district court fulfilled its duty as gatekeeper and did not abuse its discretion in excluding Professor Fischel's expert testimony.[20] There was a sufficiently

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[20] Mr. Nacchio and NACDL argue that because Professor Fischel's testimony was vital to Mr. Nacchio's defense, the exclusion also deprived Mr. Nacchio of the right to a present a complete defense. That right, however, is not absolute: it "may bow to accommodate other legitimate interests in the criminal trial process." *Young v. Workman*, 383 F.3d 1233, 1237 (10th Cir. 2004) (internal quotation marks omitted). As there was no abuse of discretion in the exclusion, there was no impingement upon Mr. Nacchio's right to present his defense. *See Chambers*, 410 U.S. at 302 (noting that the accused must comply with rules of procedure and evidence in exercising the right to present a defense). Furthermore, the principal dissent analytically misfires in purporting to identify an abuse of discretion in the district court's supposed exclusion of "important defense evidence on account of discovery violations, such as inadequate disclosure under Rule 16." Dissenting Op. at 35. As discussed further above, *supra* notes 7, 16, the district court did not exclude Professor Fischel's expert testimony in order to penalize Mr. Nacchio. Moreover, the specific suggestion that the exclusion was some sort of Rule 16 sanction is simply misguided. Instead, Mr. Nacchio suffered the natural and unremarkable consequence of failing to carry his evidentiary burden with respect to the admission of Professor Fischel's expert testimony: the district court excluded it. Mr. Nacchio's status as a criminal defendant did not relieve him of this evidentiary burden. Furthermore, although we generally find Judge Kelly's dissenting opinion to be unpersuasive, it is especially so insofar as it asserts that we have "cho[sen] expediency over due process." Kelly Dissenting Op. at 1. Far from it. As painstakingly recounted herein, Mr. Nacchio had ample opportunity to make his

developed record, a concrete reliability determination, and specific findings and discussion by the district court. *See Dodge*, 328 F.3d at 1223. In particular, the court did not abuse its discretion in finding that Mr. Nacchio did not carry his burden under *Daubert*.[21]

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case for the admission of Professor Fischel's expert testimony to support his defense. And, irrespective of "the tone of this trial," *id.*, Mr. Nacchio was obliged to attempt to make that case, consistent with the gatekeeping discretion vested in the district court by *Daubert*. Mr. Nacchio did not rise to this challenge.

[21] Noting that whether the district court abused its discretion was one aspect of the issue as to which the court granted en banc rehearing, the principal dissent attempts to use that simple point as the predicate for asserting arguments about two allegedly undisputed legal errors by the district court concerning the contents of Rule 16 disclosures and the relevancy of economic evidence. According to the principal dissent, arguments related to these purported errors are appropriate in this en banc proceeding because they allegedly played an important part in the district court's evidentiary ruling and at least partly caused that ruling to constitute an abuse of discretion. *See* Dissenting Op. at 38-43. The principal dissent's attempt to shoehorn these otherwise extraneous purported legal errors into this en banc proceeding is problematic for at least three reasons.

First, the initial premise of the principal dissent's argument is flawed: it is not undisputed that these two issues involve legal errors. As noted *supra* at note 2, whether the district court confused civil and criminal discovery standards and therefore erred in its Rule 16 determination is irrelevant here because it is patent that the district court primarily based its decision on *Daubert* and FRE 702 grounds. Therefore, acting with prudent judicial restraint, we simply have elected not to opine on the Rule 16 issue. Our act of restraint does not amount to a concession that the district court erred. As for the district court's relevancy ruling, as evident in the panel's split decision, it is far from undisputed that the district court erred. *See Nacchio I*, 519 F.3d at 1174 (Holmes, J., concurring in part and dissenting in part) ("Such reasons [as stated by the district court regarding relevance] for excluding expert testimony are perfectly

reasonable .... It was certainly permissible for the district court to conclude that [Professor Fischel's expert testimony] was not relevant. The district court could have excluded Professor Fischel's testimony on grounds of relevance alone ....").

Second, the abuse of discretion component of our en banc order naturally must be read with reference to the overarching focus of that order: that is, the district court's exclusion of Professor Fischel's testimony on *Daubert* and FRE 702 grounds. Indeed, the principal dissent's own arguments tacitly acknowledge this: "[T]he real issue in this case ... is ... whether it was an abuse of discretion to decide the *Daubert* issue on the basis of the disclosures alone, without hearing or testimony." Dissenting Op. at 34. Our en banc order did not open the door for an inquiry into every purported legal error that the district court may have made in evaluating Professor Fischel's proffered expert testimony. *See supra* notes 1, 9. The relevancy of Professor Fischel's proffered expert economic evidence was a separate issue from the primary *Daubert* issue—i.e., the reliability of Professor Fischel's methodology in arriving at his economic opinions—and, in its findings, the district court treated the two issues as distinct. True, Mr. Nacchio failed to satisfy the district court that the testimony would be *either* relevant *or* reliable. Aplt. App. 3917 (noting that the court was "concerned *not only* with the methodology" but also that the requirement that the testimony be helpful to the jury was not met); *cf. id.* at 4075-76 ("[E]ven if [Professor Fischel's proposed expert rebuttal testimony was] reliable, the Court remains of the conclusion that the testimony is of no relevancy."). However, it was the latter reliability issue that was the primary basis of the district court's ruling excluding Professor Fischel's expert testimony. And it was *only* as to the latter separate issue that this Court granted en banc rehearing. Accordingly, the mere fact that our en banc order called for consideration of whether the district court abused its discretion does not provide free license, as the principal dissent would have it, for consideration of the separate issue of the district court's finding concerning the relevancy of Professor Fischel's expert testimony regarding economic evidence.

Third, and relatedly, even if the district court's purported legal errors concerning the Rule 16 and economic-evidence relevancy issues were properly within the zone of consideration in this en

In addition to the sentence included in his response to the motion to exclude noting that Professor Fischel had undertaken "extensive review of SEC filings, press releases and other financial data," Aplt. App. 466, Mr. Nacchio considered his revised Rule 16 disclosure to be a submission on Professor Fischel's methodology. Aplee. Supp. En Banc App. 50. This filing indicated that Professor Fischel was basing his opinion on

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banc proceeding, it is not entirely clear why they would merit analytical attention. The principal dissent's assertion that "the relevance of [the district court's] legal errors to the evidentiary ruling is obvious" is *itself* far from obvious. Dissenting Op. at 42. The principal dissent offers us little more than this bald *ipse dixit* as support for this proposition.

The principal dissent does seem to rely on the notion the district court's allegedly erroneous view of these legal issues necessarily would have been factored into the court's determination of how to respond to what the court misguidedly believed to be Mr. Nacchio's "procedural derelictions" or "procedural infraction." Dissenting Op. at 42-44. As noted repeatedly herein, *see supra* notes 7, 16, 20 and accompanying text, however, the district court did not exclude Professor Fischel's expert testimony in order to penalize Mr. Nacchio for any procedural delict. The exclusion was simply the product of Mr. Nacchio's faire to carry his evidentiary burden concerning the admissibility of Professor Fischel's expert testimony.

Therefore, we are brought back to the fact that the district court treated the *Daubert* issue as a separate (and primary) component of its multifaceted critique of the admissibility of Professor Fischel's expert testimony. Consequently, even if the district court's purported Rule 16 and relevancy errors were proper subjects for consideration in this en banc proceeding, which is focused on reliability under *Daubert*, it is far from clear that we would devote more than minimal energy in inspecting these separate issues—certainly not the significant resources expended by the principal dissent—or that such attention would shed much light on the propriety of the district court's stand-alone exclusion ruling under *Daubert*.

analysis of, *inter alia*, market- and stock-related information. These assertions indicate that Professor Fischel was applying his experience to material that he reviewed to formulate an opinion. An expert witness's testimony can rely solely on experience. When that is the case, however, "the witness must explain how that experience leads to the conclusion reached, why that experience is a sufficient basis for the opinion, and how that experience is reliably applied to the facts." Fed. R. Evid. 702 advisory committee's note (2000). Mr. Nacchio did not offer any of this additional information. "The trial court's gatekeeping function requires more than simply 'taking the expert's word for it.'" *Id.* "[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert." *Joiner*, 522 U.S. at 146.

It appears that Mr. Nacchio relied on Professor Fischel's qualifications to tip the balance in favor of the admissibility of his expert testimony. In doing so, Mr. Nacchio ignored the precept that when assessing expert testimony, "the question before the trial court [i]s specific, not general." *Kumho Tire*, 526 U.S. at 156. Although Professor Fischel generally has been permitted to testify in the past, and a district court might well respect his credentials, the court had an obligation to assess the methodology that Professor Fischel had employed in the case at hand. *See id.* at 153-56; *Rodriguez-Felix*, 450 F.3d at 1122. Mr. Nacchio could not assume that his expert's testimony would be admitted because other courts had allowed it in; he had to carry his burden of demonstrating the admissibility of Professor Fischel's testimony in this particular case. Mr. Nacchio, however, failed to satisfy the district

court that Professor Fischel's testimony was reliable. Thus, the district court was well within its discretion in excluding it. *See Rodriguez-Felix*, 450 F.3d at 1125 (finding no abuse of discretion when the district court excluded testimony based on the "woefully inadequate" report regarding proffered testimony).

In *Sprint*, the Supreme Court explained that on account of the district court's familiarity with the case and greater experience with evidentiary matters, this Court must "afford broad discretion" to the court's evidentiary rulings. *Sprint*, 128 S. Ct. at 1144-45. Here, the district court properly performed its *Daubert* gatekeeping role in excluding Professor Fischel's testimony as inadmissible for lack of reliability under FRE 702, and Mr. Nacchio did not carry his burden of establishing the admissibility of Professor Fischel's testimony. Perhaps more to the point, the district court's exclusion of the testimony was not arbitrary, capricious, whimsical, or manifestly unreasonable; nor are we convinced that the district court made a clear error of judgment or exceeded the bounds of permissible choice in the circumstances.

III. CONCLUSION

Based upon the foregoing, we **AFFIRM** Mr. Nacchio's conviction and **VACATE** the prior panel opinion insofar as it reversed the district court's judgment, including Parts II(A), IV, and V, as well as the separate concurring and dissenting opinion. The remainder of the panel's decision remains in effect. The government's motion to file a supplemental en banc appendix is **GRANTED**. This Court's grant of release pending appeal is revoked, the unsecured bond executed by Mr. Nacchio in the district court is exonerated, and the stay of Mr. Nacchio's sentence of

imprisonment is hereby lifted. This case is remanded to the initial decisional panel for further proceedings relating to the unresolved sentence enhancement and asset forfeiture issues.

No. 07-1311, *United States v. Nacchio.* **MCCONNELL**, Circuit Judge, dissenting, joined by **HENRY**, Chief Judge, and **KELLY** and **MURPHY**, Circuit Judges.

Joseph Nacchio was convicted by a jury and sentenced to six years in prison after the district judge refused to allow his expert witness, Professor Daniel Fischel, to testify at his trial for securities violations. The judge disqualified the witness without hearing argument from defense counsel or testimony from the witness regarding the reliability of his methodology. The judge based this ruling on what is now agreed was a mistaken interpretation of the rules of criminal procedure. The panel reversed that ruling, and in its petition for rehearing en banc the government did not even attempt to defend the district court's rationale. Instead, the government argues—and the en banc majority agrees—that the exclusion of this witness was the defendant's fault, for failing to establish the foundation for his testimony in advance of putting him on the stand or to file a motion for permission to establish the foundation through testimony.

The flaw in the government's argument is that the rules of criminal procedure, unlike the rules of civil procedure, do not require a criminal defendant to establish the foundation for expert testimony through advance written submissions. Unless the criminal defendant is otherwise directed by the district court—something which did not happen here—he may establish the foundation for witness testimony by putting the witness on the stand for voir dire examination. The defendant responded properly to every motion made by the government, and nothing in the conduct of the defense can reasonably be construed

as abandoning or forfeiting his right to establish the reliability of the expert evidence through testimony. It was the district judge, not defense counsel, who misunderstood the procedural rules. We dissent on the ground that the defense did everything it was required to do—but that even if counsel somehow slipped up, it was an abuse of discretion for the court to shut down the primary line of defense in a criminal case on the basis of what was at worst an understandable and inconsequential mistake.

I. Parties In Criminal Cases Are Under No Obligation To Submit Written Information Sufficient To Resolve *Daubert* Issues In Advance, Or To Make A Motion For Permission To Establish Admissibility By Witness Testimony

At the heart of this case is the difference between discovery practice in criminal and civil cases, which "derives from the special constitutional constraints of criminal proceedings." *United States v. Mehta*, 236 F. Supp.2d 150, 155 (D. Mass. 2002) (Gertner, J.). In civil cases, both sides are entitled in advance of trial to know and to respond to the evidence that will be presented by the other side, including any expert testimony. In criminal cases, the defendant is entitled to keep his cards close to the vest; he may not be required to disclose his evidence or trial strategy until after the government has presented its case. These differences are reflected in the discovery rules.

Under Rule 26(a)(2) of the Federal Rules of Civil Procedure, any party who wishes to use a retained expert must give the opposing party in advance of trial a written expert report prepared and signed by the witness, containing a "complete statement" of the

witness's opinions and the "basis and reasons for them"; all data, other information, and exhibits on which the testimony is based; and the witness's qualifications, publications, previous testimony, and compensation statement. Moreover, in a civil case the opposing side is entitled to take the expert's deposition under Rules 30 and 31 and, if the expert report and deposition testimony fail to establish the reliability of the methodology, can move for summary judgment under Rule 56. If issues regarding the reliability of the expert's methodology—which we, like the majority and the parties, will call "*Daubert* issues"—are not resolved on summary judgment, they must be resolved through questioning the witness, either in a separate *Daubert* hearing outside the presence of the jury or by foundational testimony and voir dire examination on the stand prior to presentation of the witness's opinion evidence. The timing of the hearing, and whether it should be held in the presence of the jury, depend on the circumstances of the case. As the advisory committee note to Federal Rule of Evidence 104 points out: "Not infrequently the same evidence which is relevant to the issue of establishment of fulfillment of a condition precedent to admissibility is also relevant to weight or credibility, and time is saved by taking foundation proof in the presence of the jury."

In criminal cases, by contrast, neither side has a general right to discover the other's evidence, though the defendant is entitled to request and obtain certain specific types of evidence from the prosecution. Apart from Rule 16, which we discuss below, a criminal defendant may call an expert witness to the stand without any advance disclosure whatsoever. There is no requirement of an expert report; there are no

depositions of the expert; there are no motions for summary judgment to test whether there are triable issues regarding the witness's methodology. As in civil cases, the proponent of an expert in a criminal case has the burden of establishing that the witness's methodology is sound under the standards of *Daubert* and *Kumho Tire*. But absent any countervailing directive from the trial court, parties in criminal cases can, and typically do, meet this burden by eliciting foundational testimony from the witness on the stand, subject to cross-examination by the opposing party. A party in a criminal case does not have to make a motion to proceed in this fashion; it is the default procedure. As in civil cases, the questioning may be conducted in a separate hearing outside the presence of the jury, by motion of either party or of the court, or at the beginning of the witness's testimony. If the opposing party wishes to obtain a ruling on admissibility in advance of the witness's testimony, it may file a motion *in limine* or a motion to conduct the hearing outside the presence of the jury.

The majority does not dispute that this is the typical procedure for resolving *Daubert* issues in criminal cases. The majority quotes the defendant's contention that "the presumptive time for establishing the reliability of the expert's testimony is on the witness stand," and cites an amicus brief filed by the National Association of Criminal Defense Lawyers (NACDL) that states that "the prevalent practice is to address *Daubert* issues at voir dire." Maj. Op. 21, 22 n.10. The majority says it declines to "offer any definitive opinion" regarding how *Daubert* issues are ordinarily resolved, Maj. Op. 22 n.10, but it makes no attempt to dispute the defendant or the NACDL on

this point. Indeed, the majority concedes that it "may have been reasonable" for Mr. Nacchio to assume "that Professor Fischel's admissibility would be established after he took the stand." *Id.* at 22. The majority qualifies this concession only by noting, correctly, that the trial court has broad discretion to vary from the presumptive procedure and thus that a criminal defendant has "no entitlement to a particular method of gatekeeping by the district court." *Id.* at 23.

The defendant's position on this point is consistent with the discussion of *Daubert* procedures found in standard authorities. *See, e.g.*, 29 Charles Allen Wright & Victor James Gold, Federal Practice and Procedure: Evidence § 6265 (1997) ("Normally a trial court will hear qualification evidence before permitting the witness to give opinion testimony. That hearing may take place either in the presence or absence of the jury, at the discretion of the court." (citations omitted)); *see also* Jack B. Weinstein & Margaret A. Berger, Weinstein's Federal Evidence (Joseph M. McLaughlin, ed., 2d ed. 2006) § 702.02[6][b] ("Evidentiary hearings, known as *Daubert* hearings, are the most common method trial courts use to fulfill their gatekeeper function.... When the hearing occurs during trial, the court has discretion to determine whether to hold it in the presence of the jury.... The reliability hearing may also be combined with voir dire to test the expert's qualifications."); *Goebel v. Denver & Rio Grande W. R.R.*, 215 F.3d 1083, 1087 (10th Cir. 2000) ("The most common method for fulfilling this function is a *Daubert* hearing").

It is thus undisputed that the "presumptive" procedure for establishing admissibility of expert testimony is through voir dire examination of the

witness on the stand, either in a separate *Daubert* hearing or at the beginning of the witness's testimony. But this proposition merits far more emphasis than the majority gives it. If the standard or presumptive procedure is to establish reliability through examination of the witness, it follows that the defendant is not required to make a motion asking for permission to follow that procedure. Motions are required to deviate from presumptive procedures, not to follow them. To be sure, the district court has authority to impose a different set of procedures—but Judge Nottingham did not do so in this case, or if he did, he made no mention of them prior to disqualifying the witness. And to be sure, a party can waive or forfeit his right to present a witness or to qualify him through voir dire examination—but nothing the defendant did at trial can reasonably be construed as a waiver or forfeiture. Mr. Nacchio's counsel did not expressly move to be allowed to establish Professor Fischel's admissibility on the witness stand, but given that this is the presumptive procedure, a motion to that effect was not necessary; therefore, his failure to make such a motion cannot be construed as a forfeiture. The majority has cited no case in which a criminal defendant has ever been held to forfeit his right to establish witness admissibility through voir dire examination by mere failure to file a motion asking for permission to do so; the government has cited no such case; and we have located no such case. This appears to be the first.

II. The District Court Was Wrong To Disqualify The Witness On The Basis Of The Lack Of Information About Methodology In The Defendant's Rule 16 Disclosure

We address first the district court's rationale for excluding the expert witness testimony. Although no one defends that rationale anymore, the district court's error colors the entire matter.

Rule 16 of the Federal Rules of Criminal Procedure creates an exception to the usual rule that defendants need not provide notice of their intention to offer expert witnesses. Under Rule 16(b), if a defendant requests disclosure of certain evidence and the government complies, the defendant becomes obligated to make certain disclosures in return. Specifically, if the defendant requests and receives a written summary of any expert testimony the government intends to introduce, the defendant must provide similar notice of any expert testimony he intends to use. Fed. R. Crim. P. 16(b)(1)(C). These written summaries must include a description of the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications. *Id.* §§ 16(a)(1)(G), 16(b)(1)(C). The required "written summary," however, falls far short of the "complete statement" required of litigants in civil cases. *See United States v. Mehta*, 236 F. Supp.2d 150, 155–56 (D. Mass. 2002). In particular, Rule 16 does not require experts in criminal cases to provide written reports explaining their opinions or to make a written proffer containing the information required under the civil rules. In this respect, the rules are the same for government and defendant. The amicus brief for the NACDL, for instance, states that they are "unaware of any instance

in which the government has provided [their] members with a Rule 16 expert notice that laid out the full *Daubert* justification (or anything even approaching it) for the proposed testimony." NACDL Br. 4–5.

Because the defense requested and obtained disclosure of the government's experts in this case, Mr. Nacchio was obligated to disclose his experts in return. This he did. On the date set by order of the court, defense counsel provided the requisite notice of his intent to call Professor Fischel, in full compliance with Rule 16.[1] The disclosure identified the witness, stated his credentials, and provided a brief summary of the opinions he would present and the sources on which those opinions were based. The disclosure did not contain the "complete statement" of the witness's econometric methodology that would be necessary under the civil rules. Professor Fischel did not prepare or provide an expert report, which, as noted, is not required under the criminal discovery rules.

During trial, the prosecutor took the position that Mr. Nacchio's written summary of "the bases and reasons" for Professor Fischel's opinions had to include sufficient description of his econometric methodology to enable the district court to discharge its *Daubert* gatekeeping function: "Defendant has not adequately complied with Rule 16's requirements for any of the 'opinions' he proposed to offer through Professor Fischel. He has not set forth the reasons and bases for his opinions ...." App. 418. Indeed, the government filed a lengthy motion arguing that the expert

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[1] The government objected to the form of the initial disclosure and the district court required the defense to supplement, which it did. We need not determine whether this order of the district court was correct.

testimony should be excluded because "[t]*he disclosure* also does not show that Professor Fischel used a reliable methodology in reaching his opinions." *Id.* at 363 (emphasis added). This argument took two forms. First, the government argued that the evidence should be excluded as a "sanction[]" for the defendant's supposed violation of Rule 16. *Id.* at 418. Second, the government argued that because the defendant had not established the reliability of the expert's testimony in his expert disclosure, the evidence should be excluded for not having passed the *Daubert* test. *Id.* at 363 ("The *disclosure* also does not show that Professor Fischel used a reliable methodology in reaching his opinions. The *disclosure* is essentially a list of facts and conclusions—with nothing in between. There is no suggestion that Professor Fischel actually selected any reliable principles and applied them reliably to the facts, as he must.") (emphasis added). These arguments amount to the same thing, because both presuppose the defendant's obligation to make his *Daubert* showing in his written disclosure under Rule 16.

On April 5, defense counsel called Professor Fischel to the stand, but before he could even begin to establish the foundation for the witness's testimony, Judge Nottingham dismissed the jury and excluded the evidence in a ruling from the bench. Judge Nottingham accepted the government's Rule 16 argument, ruling that "the deficiencies under Daubert and Kumho Tire *in these disclosures* are so egregious that they hardly warrant the 63 pages of ink the Government has spilled in opposing the testimony." App. 3914 (emphasis added). *See id.* at 3917 ("The Court is concerned ... with the methodology, which is

absolutely undisclosed *in this expert disclosure*."). The judge ruled the expert testimony inadmissible on the ground that the defendant's written submissions on the Rule 16 issue did not contain information sufficient to establish reliability under *Daubert*. This closely resembles the ruling a judge in a civil case might make on summary judgment, if the written submissions by the proponent of a witness failed to provide any evidence of reliability. Judge Nottingham also supplied other reasons for excluding the evidence, including that Professor Fischel's testimony was not "relevant" or helpful to the jury. The judge specifically stated, however, that he was disqualifying Professor Fischel "primarily" on account of defense counsel's "gross defect in failing to reveal the methodology." App. 3921.

Judge Nottingham was evidently under the impression that the reliability of an expert's methodology in a criminal case must be evaluated on the basis of written reports or disclosures, as is typically done in civil cases, rather than on the basis of oral testimony, as is typically done in criminal cases. Indeed, he specifically stated that the witness disclosure requirement under the criminal rules is "pretty close to what is required in the civil area." App. 2041.

The majority purports to find the court's explanations for its ruling "ambiguous," Maj. Op. 17, but they are not. Judge Nottingham's conclusion that the defendant had not established the reliability of Professor Fischel's methodology was unambiguously premised on the erroneous assumption that the defendant was required to disclose the methodology in his written proffer rather than to do so through testimony. *See* App. 3916 (basing his *Daubert* ruling on

"[t]he defendant's only representation on this issue," which was a sentence in the defendant's response to the government's motion to exclude); *id.* at 3917 ("The Court is concerned ... with the methodology, which is absolutely undisclosed in this expert disclosure."); *id.* at 4075 (pointing to the lack of any "methodology or reliable application of methodology to the case" in "[t]he March 29, 2007, disclosure" as the primary reason for excluding the evidence). Not only is that what Judge Nottingham said, but it is obvious from context. Unless the judge thought the defendant had to disclose the witness's methodology in his written submissions, it would have been patently irrational for him to base his *Daubert* determination on those submissions. We do not doubt the majority's statement that "the court's ruling was grounded in *Daubert* and Rule 702 methodology concerns," Maj. Op. 18, but the point is that the court based its evaluation of those concerns solely on the written disclosures. Because the judge was wrong to believe that the disclosures had to explain the methodology, he was wrong to base his *Daubert* determination on those disclosures.

On appeal to this court, the defendant argued that this was a misreading of Rule 16(b), that his disclosure statement did not have to include an explanation of Professor Fischel's methodology, and thus that the absence of such disclosure of methodology was an improper basis for rendering a *Daubert* ruling. The government argued that Judge Nottingham was correct in his interpretation of Rule 16. This dispute over the meaning of Rule 16 was the principal issue before the panel on the expert witness question.

The panel reversed the district court's Rule 16 ruling, holding that Rule 16 does not compel the

proponent of expert testimony to disclose information sufficient to demonstrate that the witness's methodology is reliable under *Daubert*. This portion of the holding was unanimous. See *United States v. Nacchio*, 519 F.3d 1140, 1173 (10th Cir. 2008) (Holmes, J., dissenting) (agreeing with the panel majority that Rule 16 "certainly did not require [the defendant] to demonstrate admissibility"). As the panel held, Rule 16 leaves criminal defendants free to present expert witnesses without satisfying *Daubert* in advance through written expert reports. The government's argument, if accepted, would have foisted civil discovery burdens on criminal defendants. Accordingly, the panel held that Mr. Nacchio's Rule 16 disclosure "did exactly what the law required" and the district court erred in excluding the evidence on the basis of the supposed "egregious" "deficiencies" in the disclosure. *Nacchio*, 519 F.3d at 1151.

In its petition for rehearing, the government abandoned its Rule 16 argument, and all parties now seem to agree that Mr. Nacchio's disclosure was sufficient under Rule 16. If Rule 16 disclosures need not include information sufficient for the court to exercise its *Daubert* gatekeeping function, the district court necessarily abused its discretion in basing its *Daubert* determination on those disclosures. It would be like dismissing a case on the ground that the complaint failed to anticipate an affirmative defense, when it was under no obligation to do so. Judge Nottingham's stated reason for excluding the evidence is therefore wrong. Accordingly, only if there existed some alternative ground for basing its *Daubert* ruling on the written disclosures can the district court's decision be affirmed.

III. Although The District Court Has Discretion To Require The Parties To Proffer *Daubert* Reliability Evidence In Some Manner Other Than Witness Testimony, It Must Inform The Parties What Procedures It Wishes To Impose

The majority offers three rationales for concluding that the district court was within its discretion when it barred the defense from establishing admissibility through witness testimony. First, the majority rests on the trial court's discretion to determine alternative procedures and argues that the defendant had notice that he was required to establish Professor Fischel's reliability in advance of the testimony. Second, the majority argues that the defendant "abandoned" his right to proceed via testimony by failing to make a motion to do so. Third, the majority claims that the defendant conceded that his Rule 16 disclosure was his "submission" on the *Daubert* issue. In this section we will address the first of those arguments.

The majority is correct that district courts have broad latitude to determine what procedures to employ in reaching a *Daubert* determination. *United States v. Rodriguez-Felix*, 450 F.3d 1117, 1122 (10th Cir. 2006); *Goebel*, 215 F.3d at 1087.[2] But the court must provide

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[2] As in civil cases, the district court in a criminal case has discretion to require the filing of a written proffer. But in criminal cases "these procedures must be crafted in a way that respects the fact that the Defendant has no obligation to present a defense until the Government has established its case." *United States v. Impastato*, 535 F. Supp.2d 732, 743 (E.D. La. 2008); *see United States v. Poulsen*, No. 06-129 (S.D. Ohio September 28, 2007) (reproduced in Addendum to Def.'s Supp. Br. at 29) (ordering defendants to submit expert reports *in camera* to prevent the government from getting "an unjustified preview of Defendant's

adequate notice of the procedures so that the parties know what is expected. *Procter & Gamble Co. v. Haugen*, 427 F.3d 727, 742 (10th Cir. 2005). It is an abuse of discretion for a district court to exclude testimony on account of noncompliance with court-imposed procedures without first informing the parties of the new procedures and giving them a reasonable opportunity to conform. *Id.*; *see Padillas v. Stork-Gamco, Inc.*, 186 F.3d 412, 417–18 (3d Cir. 1999) ("[P]laintiff could not have known in advance the direction the district court's opinion might take and thus needed an opportunity to be heard on the critical issues before having his case dismissed."); *In re Paoli R.R. Yard PCB Litigation*, 916 F.2d 829, 856 (3d Cir. 1990) ("Having no foreknowledge of the direction that the district court's opinion might take, the plaintiffs should have been given an opportunity to be heard on the critical issues before being effectively dispatched from court."). Giving notice about changes in procedure is not "hand-holding," Maj. Op. 22 n.10; it is a fundamental element of trial fairness.

We have no quarrel with the majority's uncontroversial premise that "Mr. Nacchio had no entitlement to a particular method of gatekeeping by the district court," Maj. Op. 23, or its conclusion that "[t]he district court's failure to proceed as Mr. Nacchio anticipated does not by itself constitute an abuse of discretion." *Id.* If Judge Nottingham had imposed a reasonable set of alternative procedures, the defense

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litigation strategy"). We need not determine in this case what limits on the trial court's discretion are entailed by these considerations, because Judge Nottingham did not order the defendant to provide any proffer beyond what he (mistakenly) thought was required under Rule 16.

would have been required to follow them. He did not. One searches the record in vain for any hint that Judge Nottingham instructed the defendant that he should proceed in any fashion other than that dictated by the rules. Apart from telling defense counsel to bring his expert disclosure into compliance with Rule 16, Judge Nottingham never discussed how the defense should go about demonstrating the reliability of Professor Fischel's econometric methodology.

In its April 3 memorandum, the government requested that if the court did not exclude Professor Fischel's testimony outright, the court should schedule a *Daubert* hearing outside the presence of the jury "prior to the admission of such testimony." App. 421. The government also asked that Professor Fischel be compelled to provide "the reasons and bases for his opinions," presumably in writing, "in advance of such hearing." *Id.*[3] The court never ruled on these requests.

To be sure, after disqualifying the witness and reprimanding defense counsel for attempting to address the issue in court, Judge Nottingham said that "[a]ny argument that you wish to make could have been put in the response," App. 3921, which might possibly be interpreted as a ruling that the defense should have established the reliability of the witness's methodology in writing in its response to the government's motion to exclude. More likely, by "argument" the judge meant legal argument as to why he should permit voir dire examination of the witness,

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[3] This motion demonstrates that the government, at the time, understood that a motion was necessary lest the *Daubert* issue be decided through foundational testimony and voir dire examination in front of the jury.

but the precise meaning of the judge's words doesn't really matter. Judge Nottingham had given no notice in advance of the necessity of making a written proffer of the expert's methodology. The government had made a motion to compel a written proffer in advance of the testimony, but the court had not ruled on it. Indeed, the day before the government made its motion the judge had told defense counsel that in light of the rigorous schedule, "I'm not criticizing anybody for not submitting things in writing." App. 3603. Only two interpretations of these events are possible: either Judge Nottingham had not imposed any special procedures for establishing reliability, or he failed to inform the defendant that he had done so. Either way, it was an abuse of discretion to disallow the witness on this undisclosed ground.

The majority points to nothing in the record that indicates that Judge Nottingham imposed any additional procedures or notified the parties that he was doing so. That is because it did not happen. But the majority nonetheless denies that the defendant suffered "unfair surprise" when the court disallowed the expert evidence without hearing testimony from the witness. Maj. Op. 26–27. The majority states that "Mr. Nacchio was on notice that the admissibility of Professor Fischel's testimony under FRE 702 was at issue well before the district court issued its ruling." Maj. Op. 24. Of course he was; his counsel said as much. ("In Latin, forewarned is forearmed." App. 2042.) The surprise did not pertain to *whether* there was a *Daubert* issue, it pertained to *when* and *how* the *Daubert* issue was to be addressed. Never, prior to disqualifying the witness, did the district judge say or even imply that the issue could not be resolved in the

usual way, through voir dire examination of the witness on the stand.

The majority points to several instances in which the defense was warned that *Daubert* would be an issue. None of them would have led counsel to think that his right to address the question through foundational testimony and voir dire examination had been abrogated. During the March 22 hearing, the prosecutor stated that "it's my concern at least based on the way the disclosure is raised right now, there could be *Daubert* issues that arise with respect to certain parts of the testimony." App. 2041–42. Judge Nottingham chimed in that the relevant case was probably *Kumho Tire* rather than *Daubert*. App. 2042. The majority describes this as "at the very least, de facto warning of the imminent need for Mr. Nacchio to meet his burden." Maj. Op. 24–25. We do not agree. Putting aside that this appears to be yet another example of the prosecutor's erroneous interpretation of Rule 16 (hence the reference to the "disclosure"), the prosecutor said only that there "could be" *Daubert* issues with respect to "certain parts of the testimony." In other words, the prosecution might, in the future, object to certain parts of Professor Fischel's testimony. The prosecutor's remarks can scarcely be interpreted as notice that the defense was required "imminently" to present evidence of the expert's methodology on pain of having the entirety of his testimony excluded. As to the judge's intervention, it was nothing more than a clarification of the proper case citation. This was the district court's *only mention* of *Daubert* or *Kumho Tire* at any point prior to his ruling disqualifying the witness.

The majority points next to the government's motion to exclude Professor Fischel's testimony, which, as it observes, "invoked *Daubert* and FRE 702 numerous times." Maj. Op. 25. But the government's claim that Mr. Nacchio had failed to carry his burden to demonstrate the reliability of Professor Fischel's methodology under *Daubert* and Rule 702 was parasitic on its claim that Rule 16 compels disclosure of an expert's methodology in writing in advance of the testimony. The argument was that *the disclosures* did not satisfy *Daubert* or Rule 702. *See* Gov't Motion to Exclude, App. 363 ("The disclosure also does not show that Professor Fischel used a reliable methodology in reaching his opinions."); to similar effect *see id.* at 385, 388, 390, 393, 396, 398, 400, 403, 405, 407–08, 415. The defense disagreed with that interpretation of Rule 16, and rightly so. The government's legal error about Rule 16 cannot serve as notice that the defendant bears a burden it would not otherwise bear, no matter how often the error was repeated.

The cases cited by the majority provide no more support for its conclusion than does the record. On the contrary, they show just how extraordinary an outlier this decision will be. The majority first compares this case to *Ralston v. Smith & Nephew Richards, Inc.*, 275 F.3d 965 (10th Cir. 2001), in which the court ruled on summary judgment that the expert's own deposition showed that she was not qualified to opine on the matter at issue. The proponent of the evidence claimed "unfair surprise," asserting that she did not know that the qualifications of the expert would be an issue at the summary judgment hearing. *Id.* at 970 n.4. The court rejected the claim of surprise on the ground that the other party had devoted an entire section of one of its

memoranda in support of summary judgment to the proposition that the expert was not qualified.

These cases are not remotely similar. In *Ralston*, a civil case, the issue arose on the defendant's motion for summary judgment. The plaintiff must have known that the motion would be decided, as motions for summary judgment always are, on the evidence in the record. This included her expert's deposition testimony admitting her lack of qualifications. Our case is a criminal case where there have been no depositions. The expert in our case has not admitted to any lack of qualifications. The proponent of the expert testimony in our case had no way of knowing that the reliability of his expert's methodology would be evaluated on the basis of written submissions, since his only written submission was his Rule 16 disclosure. The judge in our case based his disqualification ruling on the failure of the defense to provide discovery that it was not required to provide, rather than on the expert's own admissions, as in *Ralston*.

The majority also relies on an unpublished opinion, *Solorio v. United States*, 85 Fed. App'x 705, 709–10 (10th Cir. 2004), another civil case in which this court rejected a claim of unfair surprise in connection with the disqualification of an expert under *Daubert*. In *Solorio*, the *Daubert* issue was first raised in summary judgment papers and then orally argued during the summary judgment hearing, during which the district judge gave the proponent numerous opportunities to explain and defend the basis for the expert's opinions. The present case could scarcely present a greater contrast. In *Solorio*, the proponent failed to establish reliability through the expert report, as the civil rules require, but the district judge nonetheless gave him

repeated opportunities to do so orally in court. In our case, the defendant fully complied with his discovery obligations, but the district court would not allow him to speak.

Procter & Gamble Co. v. Haugen is more nearly on point. In that case, like this one, the district court rendered its *Daubert* disqualification ruling at a point in the litigation when the proponent of the expert testimony "had not submitted any expert reports to the district court [and] the district court had not heard any expert testimony." 427 F.3d 727, 741 (10th Cir. 2005). Unlike this case, the other side in *Procter & Gamble* had not filed a motion to limit or exclude the evidence. This court reversed the disqualification ruling, for two reasons. First, the court concluded that the proponent of the evidence "had absolutely no warning prior to the district court's order of dismissal that the district court would be considering, let alone ruling on, the admissibility of [the expert's] testimony." *Id.* at 742. Second, and "relatedly," the court noted that "the district court failed to 'creat[e] ... a sufficiently developed record in order to allow a determination of whether [it] properly applied the relevant law.'" *Id.* (quoting *Dodge v. Cotter Corp.*, 328 F.3d 1212, 1223 (10th Cir. 2003)) (ellipses in original) (internal quotation omitted). Because of the lack of notice, the parties had not provided the district court with "detailed briefing" on admissibility, and the district court rendered no "detailed" or "specific" findings to explain its ruling—leading this court to label the ruling "off-the-cuff," *id.* (quoting *Goebel*, 215 F.3d at 1088), and to reverse.

This case, while not identical, is similar. In both, the parties were aware that *Daubert* issues were in the

offing and would have to be decided "at some point." *Id.* In both cases the record at the time the court made its ruling was inadequate to enable the court to make a proper *Daubert* judgment. In neither case did the parties know the issues would be decided prior to briefing, argument, and either submission of an expert report or testimony. Thus the proponents were caught by surprise. To be sure, our case is complicated by the government's erroneous Rule 16 motion; the defense certainly had notice that the court would decide the Rule 16 issue before the expert took the stand. But Mr. Nacchio had no notice that, apart from Rule 16, Judge Nottingham would take it upon himself to decide the merits of the *Daubert* issue "off-the-cuff," without hearing testimony or argument. In that sense, this case is similar to *Procter & Gamble* and should be decided the same way.

The majority purports to distinguish *Procter & Gamble*, but we think not persuasively. The majority states that "the expert admissibility issue here had been put before Mr. Nacchio multiple times," Maj. Op. 31, as it had—but that provides no more notice that the district court would decide the admissibility question without hearing testimony than the parties received in *Procter & Gamble*. The majority also states that "the district court's ruling offered specific support for its determination and referenced relevant filings by both Mr. Nacchio and the government," *id.*, as it did—but because the determination was based on the assumption that the defendant had to defend the expert's methodology in his written disclosure, the district court's ruling in our case is no less an abuse of discretion than was that in *Procter & Gamble*. Both cases involved a premature decision on the *Daubert*

issue without notice to the parties that they could not make their showing as the rules would lead them to expect.

The majority also points to repeated "opportunities" for the defense to file a written proffer of evidence sufficient to satisfy the *Daubert* standards or to file a request for a hearing or continuance. Maj. Op. 31–33, 34. With 20-20 hindsight, no doubt defense counsel wishes he had taken one of these "opportunities." But viewed from the perspective of the trial as it was unfolding, defense counsel had no way to know that he needed to. Under the rules, absent a contrary directive from the district court, he was entitled to establish reliability by putting the witness on the stand. He had absolutely no reason to do anything else.

In short, the majority's first alternative ground for affirmance—that the defense failed to comply with procedures imposed by the district court in its discretion—fails either because the district court did not impose any such procedures or because, if it did, it failed to inform the parties. Either way, it would be an abuse of discretion to disallow testimony on this basis.[4]

We obviously disagree with the majority's view that Mr. Nacchio received adequate notice that the *Daubert* issue would be decided before he had a chance

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[4] To be fair to the district court, Judge Nottingham did not base his ruling on the defendant's failure to comply with procedures he imposed in his discretion. That is the majority's theory. Judge Nottingham excluded the witness on the basis of his erroneous interpretation of Rule 16. It is easy to understand why the judge did not think he needed to inform defense counsel of new procedures; the judge believed he was simply enforcing the standard disclosure requirements set forth in Rule 16.

to put the witness on the stand. But that conclusion affects only this defendant. Far more troubling is the majority's holding, relegated to footnotes and utterly bereft of any citation of authority, that the defendant was not legally entitled to notice that the district court would decide the *Daubert* issue in this summary fashion. *See* Maj. Op. 22 n.10, 23 n.11. That unprecedented holding will apply in all future cases, until another en banc court convenes or the Supreme Court intercedes. It is simply not true that defendants have "no right to be schooled by the district court concerning the specific means it would use to decide the motion and the timing of its planned action." Maj Op. 23 n.11. If the district court intends to adopt a procedure other than that set forth in the rules or familiar to the parties by custom, it must give notice. *See Procter & Gamble Co.*, 427 F.3d at 742; *Padillas v. Stork-Gamco, Inc.*, 186 F.3d at 417–18; *In re Paoli R.R. Yard PCB Litigation*, 916 F.2d at 855. To deny a criminal defendant, or any party, the right to put on relevant evidence without first informing him of the means the court would use to decide its admissibility is not merely an abuse of discretion; it is a violation of due process of law.

IV. The Defendant's Reply To The Government's Motion To Exclude Did Not Constitute Abandonment Of The Right to Present Testimony In Support of Admissibility

As a second alternative ground for affirmance, the majority holds that the defendant forfeited or "abandoned" his right to present evidence in support of the reliability of Professor Fischel's methodology by his failure to request a hearing. Maj. Op. 36–37. There

are two versions of this argument. First, that "[i]f Mr. Nacchio desired an evidentiary hearing, he bore the burden of requesting one." Maj. Op. 36. Second, that the defendant's failure to request a hearing in response to the government's April 3 "Motion to Exclude Testimony by Daniel Fischel" constituted abandonment of the right. Maj. Op. 36–37. Both versions of the argument are unsupportable.

The majority denies that it is relying on a forfeiture argument, preferring to say that the defendant "abandoned" his right rather than that he "forfeited" it. Maj. Op. 37 & n.17. This is a distinction without a difference. A forfeiture occurs when a party neglects to make an argument or assert a right at the proper time, and thus loses the opportunity to do so. *See United States v. Zubia-Torres*, 550 F.3d 1202, 1205 (10th Cir. 2008). The majority states that "Mr. Nacchio necessarily lost his opportunity to mount a response to the government's challenge to the admissibility of Professor Fischel's testimony on any grounds that he failed to present before the district court ruled." *Id.* at 37 n.17 (emphasis omitted). That is a forfeiture: to say that a party loses his "opportunity" to exercise a right or make an argument if he "failed to present [it]"at the proper time is to say he forfeited it. *Cf. Mascenti v. Becker*, 237 F.3d 1223, 1231 (10th Cir. 2001) ("We are convinced that Defendant forfeited the opportunity to subject the expert testimony of Dr. Sullivan and plaintiff's other experts to a *Daubert* challenge by failure to make a timely objection before that testimony was admitted.").

The majority's assertion that "[i]f Mr. Nacchio desired an evidentiary hearing, he bore the burden of requesting one," Maj. Op. 36, is accompanied by neither

a citation of authority nor an argument. Moreover, it is logically inconsistent with the proposition, which the majority does not even attempt to dispute, *id.* at 21–22 & n.10, that the presumptive means of establishing reliability is through questioning the witness on the stand. *See* pages 4–7, above. Motions are required when a party wishes the court to employ an alternative procedure, not when it wishes to proceed in the presumptive fashion. Moreover, to be precise, Mr. Nacchio did not desire a separate "*Daubert* hearing"; his assumption was that he would establish the reliability of the expert's methodology by putting Professor Fischel on the stand and eliciting testimony about his methodology. A criminal defendant does not have to make a motion for permission to do this. He simply calls his witness to the stand and does whatever is necessary under the circumstances to establish admissibility. Defense counsel's failure to file a formal motion for a "hearing," therefore, cannot be construed as a forfeiture or abandonment of his right to put on the witness.

Nor did the defendant's failure to request a hearing in response to the government's "Motion to Exclude Testimony by Daniel Fischel" constitute a forfeiture. The government's 61-page motion argued primarily that the defendant's Rule 16 disclosure was inadequate, and that the expert should be excluded on that ground. App. 362–63; *see id.* at 418 (arguing that exclusion was an appropriate "sanction" for the defendant's failure to "obtain an adequate expert report"). With respect to each of the issues on which Professor Fischel planned to opine, the motion pointed out that the defendant's Rule 16 disclosure did not set forth any description of the methodology Professor Fischel employed, and

argued that this was grounds for exclusion. *Id.* at 385, 388, 390, 393, 396, 398, 400, 403, 405, 407–08, 415. This aspect of the motion, therefore, was nothing more than a repackaging of the argument that the defense was required to disclose methodology in the Rule 16 disclosure. The motion also argued that the evidence was inadmissible on a number of other grounds under Rule 702, which are not defended by the majority and are therefore not relevant. These included: that Professor Fischel's testimony would be a statement of alleged facts, that his testimony would not be outside the jury's ordinary range of knowledge, that his qualifications were not relevant to the particular opinions, and that his testimony might confuse or mislead the jury. The government argued that because of these flaws, along with the Rule 16 deficiencies, the testimony could be excluded as a matter of law without the necessity of a hearing. Then, on the penultimate page of the motion, the government stated: "If, however, the Court is inclined to allow any portion of the proposed expert opinion testimony discussed above based on the disclosures to date, the United States respectfully requests a hearing prior to the admission of such testimony in order to challenge its admissibility out of the presence of the jury." *Id.* at 421. The government "request[ed] that in advance of any such hearing, Professor Fischel should provide the reasons and bases for his opinions." *Id.*

The next day, the defense filed a 7-page "Reply to United States Motion to Exclude Testimony by Daniel Fischel." The first section of the reply defended the defendant's expert disclosure under Rule 16, accurately setting forth the requirements of the rule and showing that the disclosure was in full compliance. The second

section of the reply addressed the admissibility arguments the government made under Rule 702, such as whether Professor Fischel's opinion was the product of specialized knowledge, whether it was relevant, and whether it would assist the jury in understanding the evidence. The third section defended Professor Fischel's qualifications. The reply did not make explicit reference to the government's request for a *Daubert* hearing in the event these arguments for outright exclusion did not carry the day. The reply concluded with the request "that United State's [sic] Motion to Exclude Testimony by Daniel Fischel be denied." App. 468. We believe that this reply was adequate under the circumstances and that the majority is wrong to hold that it "abandoned" the defendant's right to present testimony in support of the reliability of Professor Fischel's methodology.

With regard to the government's argument that the disclosures did not establish the reliability of Professor Fischel's methodology, the reply was fully responsive, even though it did not persuade the district court. The reply showed, correctly, that the defendant's Rule 16 disclosure was sufficient. It did not, of course, even purport to establish the reliability of Professor Fischel's methodology; its point was that there was no legal requirement that the Rule 16 disclosure do so. Because Rule 16 did not require the disclosure to establish reliability, the government's arguments based on the lack of any "indication" in the disclosure that the expert employed a reliable methodology were without merit. As noted above, no one now defends the government's contention on this point.

The reply also addressed the government's most serious arguments regarding other admissibility issues

under Rule 702. This also did not persuade the district court. As part of his explanation for disqualifying the witness, though not the "primary" reason, Judge Nottingham held that Professor Fischel's testimony was not relevant and would not be helpful to the jury. App. 3919. On appeal, the panel considered this rationale on the merits and rejected it. *Nacchio*, 519 F.3d at 1155. The government did not seek review of that holding in its petition for rehearing, it was not within the questions posed by the court for en banc rehearing, and the majority does not rely upon it.

That leaves the government's request for a separate *Daubert* hearing out of the presence of the jury. The defendant's reply made no reference to that request, and it is not improbable that this is because the defense agreed with, or at least was indifferent to, the suggestion. It follows that the defendant forfeited any right to object to a *Daubert* hearing. But the defendant certainly did not forfeit or abandon any right to object to having the *Daubert* decision rendered without either a separate hearing or an examination of the witness at the beginning of his testimony. The government had not moved for any such thing, except on the legal grounds discussed above, to which the defense adequately and correctly responded. Silence regarding a *request* for a hearing cannot be construed as silence regarding *denial* of a hearing.

Indeed, the government stated in its motion that if the court did not disqualify the witness under Rule 16, "the Court would likely need to hold an evidentiary hearing." App. 420. In the face of that admission, the defendant had no reason to doubt that, if the Rule 16 and other evidentiary issues were properly decided, a

hearing would take place on the *Daubert* issues.[5] Contrary to the majority, the defendant had no need to "second" the government's motion for a *Daubert* hearing. Maj. Op. 28–29 n.14. If a party does not oppose the other side's motion, he need not respond.

The majority suggests, however, that a combination of one sentence in the introduction to the reply and the prayer for relief at the end of the reply "plausibly could be read as both opposing the government's hearing and inviting the court to rule on admissibility without further proceedings." Maj. Op. 40. We do not see how. The introductory sentence quoted by the majority reads in its entirety: "The government's arguments are without merit." App. 463. The prayer for relief reads: "For the reasons set forth above, Mr. Nacchio respectfully requests that the United State's [sic] Motion to Exclude Testimony by Daniel Fischel be denied." App. 468. Nothing in between makes any reference to the possibility that the court might make

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[5] For the first time in this litigation, the government contends in its supplemental brief that the defense was required to request a hearing pursuant to Judge Nottingham's local rule that "[a]ny party opposing [a] motion must ... state whether that party believes an evidentiary hearing is necessary." Nottingham, Practice Standards—Criminal ¶ 17 (2004). But the defense did not take the position that a hearing was required in opposition to the government's motion. The government's Motion to Exclude argued on Rule 16 and various evidentiary grounds that the testimony was inadmissible as a matter of law, to which the defense responded, also on legal grounds. Neither side thought these issues required a hearing for their resolution. The government did move for a hearing in the event the court disagreed with these arguments, but the defense did not "oppose" that motion. Judge Nottingham did not refer to the local rule in connection with his disqualification decision, and it apparently did not play a part.

its *Daubert* ruling "without further proceedings." As already noted, the government had not made any such suggestion. Judge Nottingham did not base his ruling on any such interpretation of the defendant's reply, and if he had done so, it would surely have been an abuse of discretion. It cannot serve as an alternative ground for affirmance.

V. The Defendant Did Not Concede That His March 29 Disclosure Should Be Treated As His *Daubert* Submission

As a final attempt to justify the district court's refusal to allow the defense to establish the witness's reliability through hearing or testimony, the majority leaps on a sentence in the defendant's filing concerning rebuttal testimony, and attempts to argue that this was an admission that the defendant "considered his revised Rule 16 disclosure to be a submission on Professor Fischel's methodology," Maj. Op. 32 n.15; *id.* at 48–49, *citing* Aplee Supp. En Banc App. 50. The theory seems to be that if the defense "considered" its Rule 16 disclosure statement as a submission on the *Daubert* issue, the district court was entitled to treat it as such, and to make the *Daubert* determination on the basis of the disclosure without further proceedings. *See* Maj. Op. 12 n.6. (arguing that the defendant thereby "tacitly acknowledged the legitimacy" of the district court's decision to decide the *Daubert* question on the basis of the written disclosures).

This interpretation has no support in the record. First, whatever the defendant may have said in his response on the rebuttal issue, that response was filed *three days after* the district's court's ruling excluding the Fischel testimony without a hearing. It therefore could not have been the district court's reason for

proceeding as it did. At the time of that ruling, the defendant had said nothing that could be construed as an invitation to regard the Rule 16 disclosure as a *Daubert* submission.

More importantly, the majority's interpretation of the defendant's statement is completely unjustified. Since the majority does not quote the defendant's words, we will do so: "The government has had Professor Fischel's opinion and methodology on this opinion since March 29, 2007 (see Defendant's Expert Disclosure ¶ 7). Thus, it is hard pressed to claim surprise." Aplee Supp. En Banc App. 50. This says, plainly, that the disclosure precluded any "surprise" to the government that the testimony would be presented; it does not identify the disclosure as a "submission" regarding the reliability of the testimony under *Daubert*. Rule 16(b) required the defendant to provide a "written summary" of the "basis and reasons" for his expert's opinions. Mr. Nacchio's counsel did so on March 29, which is why the government could not claim "surprise." But as we have explained, and the majority does not contest, Rule 16(b) does not require the disclosure to contain a "complete statement" of the expert's methodology so as to demonstrate admissibility, and Mr. Nacchio's disclosure did not purport to do so. The majority is therefore wrong to treat this reference to the March 29 disclosure as an admission that it contained an explanation of methodology sufficient to permit the district court to decide the *Daubert* issue.

The majority uses this mistaken claim of a concession to avoid the real issue in this case, which is not whether the disclosures adequately established reliability, but whether it was an abuse of discretion to

decide the *Daubert* issue on the basis of the disclosures alone, without hearing or testimony. The majority conducts its entire analysis of whether the district court abused its discretion as if the issue in this case were whether the defendant's disclosures as of April 5 were sufficient to satisfy the *Daubert* test. See Maj. Op. 46–51. But the defendant does not contend, and never has contended, that his written disclosures established reliability. The majority's discussion of that "issue" is an exercise in misdirection. The question is whether the district court was correct to cut the defendant off, and exclude the witness, without allowing defense counsel time to establish reliability through voir dire examination. Because Rule 16 did not require the defendant to establish reliability through written submissions, because the district court did not instruct the defendant to do so as an exercise of its discretion to depart from usual procedures, and because the defendant did not forfeit or abandon his right to establish reliability through hearing or testimony, the decision below must be reversed.

VI. Even If The Defendant's Reply To The Government's Motion Were Somehow Deficient, It Was An Abuse of Discretion To Impose The Extreme Sanction of Disallowing A Criminal Defendant's Key Witness

Even assuming, for sake of argument, that the defendant was under an obligation to "request a hearing" to establish admissibility of the expert witness through examination on the stand, we believe it would have been an abuse of discretion for a district court to impose the extreme sanction of disqualifying a criminal defendant's principal witness on account of

this omission. *See United States v. Harvey*, 117 F.3d 1044, 1048 (7th Cir. 1997) (reversing conviction because, in the absence of any "clearly-established rule or duty" violated by the defendant, the "drastic sanction" of precluding a witness was "unwarranted").

Criminal defendants have a constitutional right to present admissible evidence, and exclusion of a defendant's evidence on account of trial errors is a drastic sanction, reserved for only the most serious cases. It is an abuse of discretion for the trial court to exclude important defense evidence on account of discovery violations, such as inadequate disclosure under Rule 16, unless those violations seriously affect the trial. *Short v. Sirmons*, 472 F.3d 1177, 1188 (10th Cir. 2006) ("Where the discovery violation is not willful, blatant or calculated gamesmanship, alternative sanctions are adequate and appropriate." (citation omitted)); *cf. Young v. Workman*, 383 F.3d 1233, 1239 (10th Cir. 2004) ("Where a party has failed to comply with a discovery request, and the failure is 'willful and motivated by a desire to obtain a tactical advantage' at trial, then exclusion of the evidence 'is entirely consistent with the purposes of the Compulsory Process Clause' of the Sixth Amendment." (quoting *Taylor v. Illinois*, 484 U.S. 400, 415 (1988))). The same is true of less serious trial errors, such as defense counsel's "unwise[]" failure to "second" the government's motion for a *Daubert* hearing. Maj. Op. 28-29 n.14. As Justice Breyer has commented, it is "essential" in this context that "the courts administer the Federal Rules of Evidence in order to achieve the 'end[s]' that the Rules themselves set forth, not only so that proceedings may be 'justly determined,' but also so 'that the truth may be ascertained.'" *Gen. Elec. Co.*

v. Joiner, 522 U.S. 136, 149 (1997) (Breyer, J., concurring) (citations omitted). Nothing about the circumstances here suggests that exclusion of Mr. Nacchio's key witness was an appropriate or proportionate response to defense counsel's omission.

First, it was surely understandable, even if it was not correct, for defense counsel to assume that he would have the opportunity to establish the admissibility of the expert evidence through witness testimony. The majority explicitly notes that this assumption "may have been reasonable." Maj. Op. 22. The government shared this reasonable assumption. App. 420 (stating that if the court did not disqualify the witness under Rule 16, "the Court would likely need to hold an evidentiary hearing"). No case (at least not one that has been cited, or that we have discovered) has ever held that a criminal defendant's expert may be excluded merely because defense counsel did not move for permission to establish admissibility on the stand.

Second, far from being calculated to obtain tactical advantage, defense counsel's slip-up was wholly without consequence. The mistake on which the majority relies was counsel's failure to move for a hearing in response to the government's motion to exclude, or to "second" the government's motion for a hearing. Yet the record demonstrates that this omission was of no benefit to the defense, did not delay the trial, and did not change the course of the trial in any way. The night before Professor Fischel was scheduled to take the stand, the district judge had not yet looked at the government's motion to exclude. App. 3834. The next morning, in court, Judge Nottingham asked the prosecutor who was going to cross-examine Professor Fischel, App. 3870, which

indicates that at this point the judge assumed that Professor Fischel would testify, notwithstanding defense counsel's failure to file a motion to that effect. The government expressly acknowledged that, unless the court agreed with its Rule 16 or other admissibility arguments, Professor Fischel would be called to the stand. App. 420. That is why the government needed to file a motion asking the court to schedule a separate *Daubert* hearing, away from the jury, in advance of the testimony. No one acted on the assumption that, because defense counsel had not requested a hearing in writing, the witness would be disqualified. Whether the defense asked to proceed by testimony in its reply to the government's motion or would do so orally when Professor Fischel took the stand was of no practical significance.

Third, as the Supreme Court explained in *Koon v. United States*, 518 U.S. 81, 100 (1996), "[t]he abuse-of-discretion standard includes review to determine that the discretion was not guided by erroneous legal conclusions." Judge Nottingham's exercise of discretion with respect to defense counsel's failure to file a written motion for a hearing is inseparable from his legal errors regarding Rule 16 and the relevance of economic expertise. In determining whether to disqualify the witness for counsel's misstep, it would surely be significant to the judge that, in his eyes, the defendant had made "egregious" and "gross" failures to comply with his disclosure obligations, rather than merely having omitted to make a written motion—the sort of failing Judge Nottingham had seemed to say he would not criticize. App. 3603.

Even more so, the judge must have been influenced by his conclusion that, quite apart from methodology,

the evidence excluded was irrelevant and would be confusing to the jury. In his explanation of his disqualification ruling, Judge Nottingham articulated a contempt for expert economic evidence that raises serious questions about any exercise of his discretion in this matter. He described Professor Fischel's proposed testimony—without knowing anything more about it than was described in the cursory "written summary" required under Rule 16—as "a waste of time" that would "mislead the jury" by "inviting the jurors to abandon their own common sense and common experience and succumb to this expert's credentials." *Id.* at 3919, 3920. He said, among other things, that the jurors had no need of expert evidence in determining whether Mr. Nacchio had an "economic incentive to trade or not trade on inside information here," App. 3917; that analysis of the defendant's trading patterns was "essentially irrelevant," *id.*; that economic analysis "is within the common knowledge of the jury," *id.* at 3918; that an analysis of whether Mr. Nacchio's sales could be explained on the basis of the "economics of diversification" is "a piece of elucidation we really don't need here," *id.*; and that a comparison of Mr. Nacchio's trades to those of other CEOs or Qwest directors at the same time, who lacked Mr. Nacchio's inside information, is "almost preposterous." *Id.* at 3919. He opined that expert evidence is no more necessary in a complex securities matter than in "a simple negligence case." *Id.* at 3841. These statements are in sharp conflict with the advisory committee note to Federal Rule of Evidence 702, which describes "the venerable practice of using expert testimony to educate the factfinder on general principles," specifically mentioning as an example "how financial markets respond to corporate reports."

On appeal the panel held that the district's court's exclusion of the evidence on the ground that economic analysis is irrelevant and misleading in a securities case of this sort was an abuse of discretion. *Nacchio*, 519 F.3d at 1156. The government did not petition for rehearing to review the panel's conclusion on this point, and the majority does not breathe a word in support of the district court's dismissive view of economic analysis. That the district court erred in this respect is therefore undisputed. Because the district court's exercise of discretion was "guided by [these] erroneous legal conclusions," the defendant is entitled to reversal. *Koon*, 518 U.S. at 100.

The majority disregards the district court's erroneous view of the relevance of economic evidence on the ground that "review of this ... issue was not sought on en banc rehearing." Maj. Op. 19 n.9. That is upside-down. The panel explicitly *reversed* the district court's relevancy ruling, and the government's decision not to seek rehearing on that issue means that holding is now undisputed. It does not make the holding disappear. Even though the panel's opinion was vacated, as the majority points out, *id.*, the district court's errors were still errors; no one defends them. Unless the errors were harmless, *see United States v. Labasida-Segura*, 396 F3d 1140, 1143 (10th Cir. 2005), they necessitate reversal of the district court's decision.

The majority also seems to suggest that the district court's relevancy ruling is outside the scope of this en banc proceeding. Maj. Op. 19 n.9. Not so. One of the issues posed in the en banc order was whether the district court "abuse[d] its discretion in disallowing the evidence." *United States v. Nacchio*, 535 F.3d 1165

(10th Cir. 2008) (order granting petition for rehearing en banc) (quoted at Maj. Op. 3 n.1). This court has held time and time again that a district court abuses its discretion if it applies the wrong legal standard. *E.g.*, *Westar Energy, Inc. v. Lake*, 552 F.3d 1215, 1224 (10th Cir. 2009); *RoDa Drilling Co. v. Siegel*, 552 F.3d 1203, 1208 (10th Cir. 2009); *United States v. Ramirez*, 304 F.3d 1033, 1035 (10th Cir. 2002); *Dominion Video Satellite, Inc. v. EchoStar Satellite Corp.*, 269 F.3d 1149, 1153 (10th Cir. 2001). In its explanations for the evidentiary ruling, the district court made at least two glaring legal errors, which no one—neither the government nor the majority—now defends. First, confusing the civil and criminal discovery rules, the court held that the defendant's Rule 16 disclosures were egregiously deficient because they failed to set forth the expert's econometric methodology. App. 3914, 3917. Second, the court held that expert economic testimony in this case would be irrelevant and a waste of time. *Id.* at 3917–20. The abuse of discretion issue brings these errors squarely before this en banc court. That the court's decision to exclude the evidence was based in significant part on these errors of law renders the ruling an abuse of discretion.

The majority does not defend the district court's holdings on these points; it all but ignores them, and conducts its analysis of abuse of discretion without taking them into consideration. *See* Maj. Op. 46-52. The majority offers no explanation why it regards the legal errors that informed the district court's decision as "not germane." *Id.* at 20 n.9. It simply declares them so.

It is black letter law that a district court's legal errors are relevant to whether it abused its discretion.

Koon, 518 U.S. at 100; *Westar Energy*, 552 F.3d at 1224; *RoDa Drilling*, 552 F.3d at 1208; *Ramirez*, 304 F.3d at 1035; *Dominion Video Satellite*, 269 F.3d at 1153. Judge Nottingham certainly regarded the supposed disclosure deficiencies and irrelevance of economic analysis as material to his evidentiary ruling. He said so, repeatedly. The judge explained that he was disqualifying Professor Fischel "primarily" on account of defense counsel's "gross defect in failing to reveal the methodology" in the disclosures. App. 3921. The other principal reason he gave for the decision was the "irrelevan[ce]" of economic testimony. *Id.* at 3919. When he refused to allow Professor Fischel even to testify in rebuttal, the judge repeated these two rationales: that "[t]he March 29, 2007, disclosure contained no methodology or reliable application of methodology to the case," *id.* at 4075, and "even if it were reliable, the Court remains of the conclusion that the testimony is of no relevancy." *Id.* at 4075–76. We are baffled that an appellate court could declare certain reasons not "germane" when those were the reasons given by the district court for its decision.

Even apart from Judge Nottingham's own words, the relevance of his legal errors to the evidentiary ruling is obvious. As we have already noted, in determining whether counsel's procedural derelictions should result in disqualification of the criminal defendant's key witness, it must necessarily have been significant to the judge that they constituted (he thought) "egregious" and "gross" violations of the defendant's disclosure obligations. Similarly, Judge Nottingham's notion that economic testimony is misleading and a waste of time must have influenced his ruling. A court must balance any procedural

omission regarding the introduction of evidence against the importance of that evidence to the truth-seeking function of the trial. If the court regards the testimony as a "waste of time," this must necessarily affect its assessment of the balance. Indeed, if the court did not take into consideration the seriousness of the procedural infraction and the importance of the evidence to the defense, it would likely be an abuse of discretion. Those are among the most important factors the court is supposed to consider. *See United States v. Bahamonde*, 445 F.3d 1225, 1231 (9th Cir. 2006) (listing factors a district court must consider before excluding a defense witness's testimony); *Short v. Sirmons*, 472 F.3d 1177, 1188 (10th Cir. 2006) (noting the importance of whether the procedural infraction was "willful," "blatant," or in "bad faith"); *Fendler v. Goldsmith*, 728 F.2d 1181, 1188 (9th Cir. 1983) (describing the importance of the witness as the "most significant" consideration). If the considerations that guided the court were based on incorrect understandings of the law, as these were, the court's exercise of discretion was necessarily distorted.

Discretion involves a sense of proportion. Not every violation of procedural rules warrants the nuclear option of disallowing the defense to present its case. As the Seventh Circuit observed in *Harvey*, "[t]he stakes in criminal prosecution are always high, and defendants' Sixth Amendment rights must be protected to ensure that the truth is ultimately found." 117 F.3d at 1048. We cannot regard the sanction here as proportionate to the procedural omission, which was both understandable and inconsequential. It strongly appears that the district court's exercise of discretion was affected by its unsupportable views regarding

Rule 16 and the value of economic expertise. We have nagging doubts about the district judge's sense of fairness toward this defendant. If the decision here was not an abuse of discretion, we wonder what one would look like.

VII. Conclusion

The defendant complied with the rules of criminal procedure. The district court's ruling to the contrary was based on a confusion between civil and criminal discovery rules. Although the district court had discretion to impose its own procedures for litigation of the *Daubert* issue, it did not do so, or if it did, it failed to inform the parties so that they could conform to the new procedures. The defendant's response to the government's motion to exclude cannot be interpreted as a forfeiture or abandonment of his right to establish the admissibility of the evidence through the expert's testimony, either at the start of the witness's testimony or in a separate *Daubert* hearing outside the presence of the jury, as had been requested by the government. But even if defense counsel was derelict in failing to file a written motion for a *Daubert* hearing, it was an abuse of discretion for the district court to exclude the defendant's key testimony for that reason. We therefore respectfully dissent.

No. 07-1311, *United States v. Nacchio*

KELLY, Circuit Judge, dissenting.

It is indeed unfortunate that the court chooses expediency over due process. It is equally unfortunate that the court attempts to spin the facts to elevate a Rule 16 challenge to one based upon Daubert and Fed. R. Evid. 702. That Mr. Nacchio's counsel should have had the prescience to anticipate the trial court's mercurial procedure is unsupported by the record, and unsupportable. Although the court suggests that there were numerous opportunities to have (a) provided more argument and evidence on methodology, (b) requested a hearing, or (c) requested a continuance, all of these suggestions presuppose that a rational lawyer would anticipate that a criminal trial court would (1) misunderstand the scope of what is required under Rule 16, (2) employ a variant procedure for the admissibility of crucial expert testimony, and (3) not notify the parties of this procedure.

Moreover, given the tone of this trial, it is quite likely Mr. Nacchio's counsel would have been prohibited from doing exactly what the court suggests he should have done. Culminating with the remark that "it's [not] an interactive process where you get to argue later on," App. 3921, Mr. Nacchio was prevented from calling his main witness and then deprived of the right to put on an effective defense. To the extent that the court suggests that the trial court gave Mr. Nacchio every opportunity by waiting to rule until Dr. Fischel was actually called, nothing could be further from reality. As noted by this court, the district court knew that the parties were awaiting a ruling on the Rule 16 motion and deliberately declined to rule until the very morning Dr. Fischel was to testify. This

becomes even more egregious when placed in the context of how the trial court proceeded after the second Rule 16 disclosure. In the middle of a complex criminal trial, the government filed a 63-page motion clearly aimed at the Rule 16 disclosure; the defense was given overnight to respond, and a ruling not based on the taking of any evidence or listening to any argument was rendered the next morning. Counsel then was denied an opportunity to confront the underlying basis of the ruling. Our founders must have had similar scenarios in mind when they wrote "nor shall any person ... be deprived of life, liberty, or property, without due process of law ...." U.S. Const. amend. V. We reverse judgments when a district court exercises its discretion on a material matter based upon an incorrect view of the law and when a defendant has not been given an adequate opportunity to be heard—that is what happened here. I would reverse and remand for a new trial. I join Judge McConnell's dissent.

No. 07-1311, *United States v. Nacchio*

HENRY, J., dissenting, jointed by **KELLY**, Circuit Judge:

I join the dissent of Judge McConnell that fully covers these matters. However, I feel strongly enough to add a few thoughts of my own.

This was not an easy case. Following a sixteen-day trial, involving a massive 42-count indictment, a jury deliberated for six days prior to reaching a decision. Yet, the district court, seemingly driven by some internal time schedule, deprived Mr. Nacchio of his key expert witness, Professor Daniel Fischel. Professor Fischel would have testified in this complex case on an issue that is a specific example of the very testimony contemplated by Rule 702. *See* McConnell Dissent at 37.

While the majority declares that the district court "made clear [its] need for some proffer of data or literature underlying [Professor Fischel's] assumptions and conclusions," Maj. Op. at 35, the majority acknowledges that the district court made "ambiguous" and "enigmatic" references. *See id.* at 17-18. The subsequent multi-page explanation of the district court's ambiguous directions belies that the district court was clear; indeed, the fact that Mr. Nacchio's experienced team of lawyers, as well as a few judges of this court, missed the district court's "enigmatic" direction suggests a certain opacity.

The majority would have us believe Mr. Nacchio's lead counsel simply and inexplicably failed to perform the basic task of qualifying the witness, for no good reason. According to the majority, the defense knew what was necessary and had a number of opportunities to qualify the witness, but instead did nothing. This is

highly unlikely. Far more likely, in my opinion, is that the defense was blind-sided: defense counsel expected to be able to qualify the witness in the usual way and was never told otherwise—only to find out, too late, that the district judge had made up his mind on the basis of the skeletal disclosure statement, and had decided to exclude the witness without hearing argument or testimony. If the majority is correct that the defense had notice that it had to present the expert's methodology in writing, or had to file a motion, then why did counsel not do so?

It would not have been difficult to establish the admissibility of Professor Fischel's expert testimony. Indeed, Professor Fischel has provided expert testimony on financial and securities issues at least 200 times, including for the government. *See* Aplt's Br. of October 9, 2007, at 40. I know of no court that has ever excluded his testimony.

Of course, eminent scholarship alone does not guarantee admissibility. Mr. Nacchio was also required to comply with the rules of evidence, and, in particular, Rule 16. His Rule 16 disclosure provides the requisite summary of Professor Fischel's opinions, and the bases and reasons for those opinions: Professor Fischel was expected to testify that, among other things, based upon his analysis of the economic evidence, Mr. Nacchio's stock sales during the disputed period were not based on material non-public information. Def's filing of March 29, 2007, at 3. To reach this conclusion, Professor Fischel engaged in

> (i) a comparison of the magnitude and timing of the Questioned Sales with the magnitude and timing of Mr. Nacchio's sales in prior periods; (ii) a comparison of the magnitude and timing of the

> Questioned Sales with public statements by Mr. Nacchio and requests made by the Qwest Board as to how and when sales should occur; (iii) the relationship between the magnitude of the Questioned Sales and Mr. Nacchio's saleable holdings; (iv) a comparison of the Questioned Sales with other contemporaneous stock transactions by Qwest; (v) an analysis of whether the Growth Share Payment created any incentive to trade on the basis of inside information; (vi) stock sales by other Qwest insiders in the period in which the Questioned Sales occurred; and (vii) stock sales by senior executives of other companies in the period ....

Id. In essence, Professor Fischel was to opine on Mr. Nacchio's trading conduct during the disputed period, basing his opinion on the following: a comparison of the disputed sales with Mr. Nacchio's selling history, as well as other similarly situated senior executives; an evaluation of the incentives to trade throughout the disputed period; and the reaction of the market to disclosure of the information on which Mr. Nacchio allegedly traded. Had the district court admitted this evidence, we would not have questioned it for a nanosecond.

If the district court had any doubts about the reliability or relevance of this testimony, all it had to do was allow the defense and the prosecution to question Professor Fischel and thus compile a record. This would not have taken much time and could have been done out of the presence of the jury, as the government asked.

In Anglo-American jurisprudence, the goal is to admit all relevant, reliable, and useful evidence. The

judicial process reflects this goal—our rules of evidence have a "liberal thrust." *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 169 (1988). The rules on expert testimony are "notably liberal." *Krist v. Eli Lilly & Co.*, 897 F.2d 293, 298 (7th Cir. 1990) (citing Fed. R. Evid. 702). When Fed. R. Evid. 702 was amended to account for the Supreme Court's decision in *Daubert*, the Advisory Committee emphasized that "the trial court's role as gatekeeper is not intended to serve as a replacement for the adversary system." Fed. R. Evid. 702 advisory committee's note (citing *United States v. 14.38 Acres of Land Situated in Leflore County, Mississippi*, 80 F.3d 1074, 1078 (5th Cir. 1996)). Instead, "[v]igorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence." *Id.* (citing *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579, 595 (1993)). Thus, under Fed. R. Evid. 702's codification of *Daubert*, the general rule of liberal admission of proper evidence is retained. The role of the district court is that of a gatekeeper, a tender or monitor who liberally allows the entrance of proper evidence; it is not a portcullis, excluding qualified patrons for indeterminate reasons.

Although, as Judge McConnell points out, we review a district judge's ultimate decision to admit or exclude expert testimony for an abuse of discretion, we review *de novo* whether the district court performed its gatekeeper function and applied the proper legal standards in doing so.[1] *Dodge v. Cotter Corp.*, 328 F.3d

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[1] Because Mr. Nacchio did not argue for *de novo* review under the theory that the district court failed to perform its gatekeeper function and failed to apply the proper legal standard in doing so,

1212, 1223 (10th Cir. 2003). In evaluating the conduct of the district court, it is important to keep in mind context—the purpose of trial is to ascertain the truth. *See Maryland v. Craig*, 497 U.S. 836, 857 (1990) (discussing the "truth-finding function of the trial itself" (citing *Coy v. Iowa*, 487 U.S. 1012, 1032 (1988) (Blackmun, J., dissenting))). The United States Constitution, and in particular the Sixth Amendment, protect and support the "truth seeking goal" of criminal trials. *Id.* Thus, the trial judges, as evidentiary "gatekeepers," must screen and balance the evidence. *See, e.g., Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 145 (1999).

We, as an appellate court, are charged with reversing district court judgments that are "arbitrary, capricious, whimsical or manifestly unreasonable." *Dodge*, 328 F.3d at 1223 (internal quotation marks omitted). And, reviewing the district court's ultimate determination of whether to admit or exclude testimony under the proper legal standard for abuse of discretion, I would reverse. It was plainly wrong for the district court to make its *Daubert* determination on the basis of a Rule 16 disclosure alone. And it was plainly wrong for the district court to deny the defendant the right to establish admissibility without prior, clear notice of how he was supposed to proceed.

The district court's draconian decision to exclude Professor Fischel as an expert flies in the face of the truth-finding goals of trial, the constitutional safeguards to a full defense, the liberal thrust of the rules of evidence, and amounts to exactly the type of

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and because I believe Mr. Nacchio succeeds under an abuse-of-discretion theory, I will refrain from further discussion of the *de novo* standard.

manifest unreasonableness we, as a reviewing court, should reverse.

And, though I fear for today's result, I do not believe this case is over. If "the district judge made clear his need for some proffer of data or literature underlying the expert's assumptions and conclusions, [and] the defense offered practically nothing, despite repeated opportunities to do so," Maj. Op. at 35, (citing *United States v. Brien*, 59 F.3d 274, 277 (1st Cir. 1995)), then defense counsel behaved inexplicably, which is to say they performed below the level expected of competent counsel. That means we will most likely see these issues return in the form of a § 2255 claim for ineffective assistance of counsel. The fact that a possibly meritorious § 2255 claim is waiting has no direct effect on what we do here now. Nonetheless, the majority's scenario, which depends on a holding that counsel's ineffectiveness possibly rose to a level of constitutional infirmity, suggests to me an alternative explanation: the district court simply was *not* clear, and it abused its discretion in excluding Mr. Nacchio's expert.

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

UNITED STATES of America, Plaintiff–Appellee,

v.

Joseph P. NACCHIO, Defendant–Appellant.

No. 07-1311.

Filed: March 17, 2008.

519 F.3d 1140

Before KELLY, McCONNELL, and HOLMES, Circuit Judges.

McCONNELL, Circuit Judge.

A Denver jury convicted Joseph Nacchio, the former CEO of Qwest Communications International, Inc., of nineteen counts of insider trading. Mr. Nacchio appeals, arguing that the evidence was insufficient to convict him, that the jury was improperly instructed, and that the trial judge incorrectly excluded evidence—expert testimony and classified information—important to his defense. We agree that the improper exclusion of his expert witness merits a new trial, but we conclude that the evidence before the district court was sufficient for the government to try him again without violating the Double Jeopardy Clause.

I. BACKGROUND

A. Qwest's Revenue Projections

In July 2000, Qwest completed a merger with U.S. West, another (larger) telecommunications company. Mr. Nacchio told employees upon completion of the merger that "the five-year business plan is ... grow, die, or sell." Aplee.'s Supp.App., exh. 514A. In September 2000, he laid out new revenue, earnings, and growth targets for Qwest's next year. He announced a public prediction, or "guidance," of $21.3 to $21.7 billion in expected revenue in 2001. Qwest also prepared a separate set of internal revenue targets, higher than the public guidance. Internal targets were typically set higher than public targets to encourage employees to exceed public targets. In addition, performance bonuses were paid to employees who met or exceeded internal targets. During most of the time relevant to this litigation, the 2001 year-end internal target was $21.8 billion, which was $500 million more than the bottom of the public guidance.

At the time, some Qwest employees expressed concern that the guidance and targets were too high. That September, for example, Robin Szeliga, Qwest's vice-president of financial planning, received a memo from two financial analysts who worked for her. The memo, called a "risk estimate," forecast problems with Qwest's revenue guidance. Ms. Szeliga shared the contents of the memo with Qwest's Chief Financial Officer, Robert Woodruff, and later with Mr. Nacchio. The memo suggested that Qwest could make as little as $20.4 billion, a shortfall of $900 million from its public target.

One particular problem was that Qwest had traditionally relied on revenues from long-term leases,

known as indefeasible rights of use (IRUs), to use space on Qwest's fiber optic network. Because Qwest collected money for the entire lease up front, IRU sales generated one-time revenue rather than a stream of recurring income. Therefore, to meet its 2001 public target, Qwest executives determined that Qwest had to make an "aggressive pivot" or "shift" from its reliance on the sale of IRUs to recurring revenue streams, such as standard consumer phone service. App. 2177, 2600. In fact, even though Qwest had a poor track record in growing recurring revenue, the 2001 budget required Qwest to double its 2000 growth rate for recurring revenue.

As early as December 2000, Qwest executives told Mr. Nacchio that this shift from IRUs to recurring revenue had to occur by April 2001 and he agreed. If Qwest failed to sign up enough new customers early in the year, it would not later benefit from sufficient compounding to close its third and fourth quarter budget gaps and would be forced to revise its public guidance downward.[1] Mr. Nacchio understood that a slow start in obtaining new recurring revenue would have a "snowball effect" which would doom Qwest's year-end target for 2001. App. 2494. In January 2001, Mr. Nacchio acknowledged the importance of this when he told his sales staff that "something big" had to happen "by April" and that the first half of 2001 was "absolutely critical." App. 2178; Aplee.'s Supp. App. exh. 551A, 559B. Although Qwest insiders clearly

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[1] Recurring revenue that begins early in the year increases annual earnings more than recurring revenue that begins later. For example, subscribers who begin service in January pay for 12 months of service while those who begin in December only pay for 1 month.

appreciated the risk inherent in the public guidance, it was not Qwest's policy to disclose the portion of its income attributable to IRU sales, and thus the public was unaware of the degree of this risk.

Qwest's revenues met internal targets during the first two quarters of 2001, largely due to IRU sales. However, there was ominous news. In early April, Mr. Nacchio had conversations with Greg Casey, Qwest's executive vice-president of wholesale markets, about the company's sales of domestic IRUs. Mr. Casey told him:

> [T]he IRU market was drying up, that after the second quarter—n the second quarter, we felt like we were draining the pond in terms of the IRU deals that were out there, and that we couldn't rely on IRUs—I couldn't see—have any visibility to what IRUs would be doing after the second quarter.

App. 2496.

Similarly, Ms. Szeliga testified that on April 9:

> [T]he plans that we had at this point to cover estimated gaps were IRUs, and we had spoken with Mr. Nacchio ... about the fact that the IRU market was worsening, in other words, there wasn't as much demand for this product. So ... the plan was very risky if we were just going to rely on IRUs.

App. 2210–11. Mr. Nacchio also learned on April 9 that recurring revenue was off by 19%, indicating that the company was well short of increasing its recurring revenue in time to reduce its third and fourth quarter budget gaps. At the same time, however, Mr. Nacchio was told at a company meeting that even "with all of the debates ... the internal current view of Qwest was

that they would reach $21.5 billion by December 31st, 2001," still meeting the public projections. App. 2323.

On April 24, Qwest announced its first quarter earnings in a press release, and Mr. Nacchio conducted a conference call to investors. In that call, Mr. Nacchio announced that the company was "still confirming" its previous guidance regarding long-term growth. App. 1598. He did not break down Qwest's earnings into IRUs and recurring revenue. Later that day, Mr. Nacchio met with investors in Los Angeles, who pointed out that other telecommunications companies had lowered their guidance. One of them asked Mr. Nacchio how Qwest was going to meet its growth targets, saying "now was the time for [Qwest] to take [its] numbers to believability." App. 1599. Mr. Nacchio responded that Qwest had better products and better management, and stressed its strong revenue growth in the category of "data and IP." App. 1605. One-time transactions made up a portion of this revenue, but Mr. Nacchio did not mention this. Lee Wolfe, Qwest's vice-president of investor relations, testified that investors asked, "[m]any times," for "the makeup of data and IP," but that Mr. Nacchio refused to tell them. App. 1600. In fact, as analysts and investors repeatedly requested a breakdown of Qwest's revenue during the first quarter of 2001, insiders such as Mark Schumacher, the company's controller, advocated disclosing the information. However, Mr. Nacchio, who retained the final say over Qwest's public disclosures, declined to do so.

B. The Defendant's Stock Sales

At approximately the time Mr. Nacchio was receiving these internal reports regarding IRU sales and recurring revenue and assuring investors that the

company was on track to meet its public guidance, he was selling over a million shares of Qwest stock. This occurred a few months before the company was forced to lower its guidance by a billion dollars, the amount previously estimated by Qwest's financial officers, and the stock lost half its value. These sales are the basis of the government's charge that Mr. Nacchio was trading on inside information. Mr. Nacchio claims, however, that a full understanding of the context of his sales proves otherwise.

Like many highly-paid CEOs at the time, Mr. Nacchio received a substantial portion of his compensation in stock options rather than in cash. Options are a common part of CEO salaries because they provide incentives to perform. Option compensation also provides cash-flow advantages to the company, because a company expends no cash when it grants them, and, at one time, a company did not need to account for the cost until the option was exercised. *See* Share–Based Payment, Statement of Fin. Accounting Standards No. 123 (Fin. Accounting Standards Bd.2004); Kevin J. Murphy, *Explaining Executive Compensation: Managerial Power versus the Perceived Cost of Stock Options*, 69 U. Chi. L.Rev. 847, 859-60 (2002); Fischer Black & Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. Pol. Econ. 637 (1973). Among Mr. Nacchio's holdings as of October 2000 were options for $7.4 million in Qwest stock, with an expiration date of June 2003.

One way that a corporate official can dispose of stock without liability for insider trading is to do so pursuant to a fixed sales plan. Under SEC rules, if a person has no material inside information when he "[a]dopt[s] a written plan for trading securities," and

that plan sets fixed rules for when he will buy and sell shares in the future, then his trades are not "on the basis of" inside information even if he later does acquire inside information. 17 C.F.R. § 240. 10b5–1 (c). Qwest's general counsel, Drake Tempest, was required to approve each stock sales plan entered into by each Qwest officer; doing so required a determination that the officer was not in possession of material nonpublic information at the time he entered into the plan. Except for sales according to a fixed sales plan, Qwest policy only permitted officers to sell stock during short "trading windows" each quarter immediately after quarterly earnings were announced. App. 1879.

In October 2000, Mr. Nacchio announced that he would exercise options and sell approximately one million shares each quarter. This would enable him to exercise his $7.4 million in options before their expiration date, while spreading his sales out over time to avoid the risk of a stock drop that comes when too many shares are sold at once. Mr. Nacchio did not actually enter into a formal trading plan in October, but he did so—briefly—in February 2001, which was approved by Tempest. He cancelled the plan less than a month later, when Qwest's stock fell below $38 per share. At that time, he stated, "I would expect to return to my prior practice of making sales in quarterly trading windows, or, in, appropriate circumstances consider entering into a new daily sales program if I believe the stock price is more realistic." App. 4803. He now points to this decision as evidence that, rather than having knowledge of an impending revenue shortfall with attendant decline in stock price, he believed the stock price would remain above $38.

The second-quarter trading window began on April 26, 2001, with Qwest's stock at $39 per share. Between then and May 15, Nacchio sold 1,255,000 shares of Qwest as the share price hovered between $37 and $42. His rate of sales in those weeks was about four times his average rate from 1998 to 2000, but only slightly more than the million shares per quarter he had declared his intention to sell in his October 2000 announcement. At the end of the May trading window, Mr. Nacchio entered into a second automatic sales plan, approved by Tempest, to sell 10,000 shares a day as long as the stock price was at least $38 per share.

On May 29, 2001, Qwest's stock price dropped below $38, where it has remained since. Mr. Nacchio sold no more shares after that, and finished the year with more vested options than he had owned at the beginning. He made no attempt to sell any of the Qwest stock (other than options) he held in his personal account, nor that owned by his family.

C. The Collapse of Qwest Stock

During the next few months, the internal warnings regarding overreliance on a dwindling pool of IRU sales were increasingly confirmed. On August 15, Qwest disclosed its IRU sales in a filing with the SEC.App. 1672. The immediate effect on Qwest's stock price was negligible, but it had been in decline both before and after. Lee Wolfe testified that "there had been ... some disclosure after the first quarter," that some of Qwest's revenue was one-time rather than recurring, "[b]ut they were not—the magnitude was not known," until August. App. 1673. On September 10, 2001, Mr. Nacchio lowered Qwest's public guidance by one billion dollars. Mr. Wolfe testified that Mr. Nacchio and Drake Tempest had sought to put enough

time between the disclosure regarding reliance on IRU sales and the change in guidance that it would not seem as if Mr. Nacchio had been concealing information. By September 21, Qwest's stock had fallen 60% from its January level. During the same period, the Dow Jones Industrial Average dropped approximately 24% and the NASDAQ composite index dropped 46%.[2]

D. Prosecution and Trial

In December 2003, Mr. Nacchio was indicted and charged with 42 counts of insider trading. The government alleged that Mr. Nacchio's sales from January to May 2001 were on the basis of inside information, because he had material nonpublic information about Qwest—specifically that the company was relying heavily on IRU sales, a non-recurring source of revenue to meet its first and second quarter public guidance, and that the company had not made the needed shift to recurring revenue which placed the company at substantial risk of not meeting its year-end guidance. After a sixteen-day jury trial, the jury deliberated for six days and convicted Mr. Nacchio on the nineteen counts of insider trading covering his trades in April and May 2001. It acquitted him of the counts covering the trades from January to March. The district court then sentenced Mr. Nacchio to six years' imprisonment on each count, to run concurrently, two years' supervised release on each count, to run concurrently, fined him $19 million, and ordered him to forfeit over $52 million more.

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[2] *See* http://money.cnn.com/quote/historical/historical.html?symb=INDU; http://money.cnn.com/quote/historical/historical.html?symb=COMP.

Challenging his conviction, his sentence, and the forfeiture, Mr. Nacchio appeals to this Court.

We reverse his conviction and remand the case for a new trial. In Section II, we discuss the evidence that Mr. Nacchio was prevented from using at trial, and explain why the district court's error entitles him to a new trial. We cannot stop there, however, because the government is entitled to try the defendant a second time only if its evidence at the first trial was legally sufficient. In Section III, therefore, we explain the government's theory of the case and discuss the sufficiency of the evidence in light of the jury instructions, concluding that a properly-instructed jury could have found the Defendant guilty of insider trading. Finally, in Section IV we discuss the nature of the remand.

II. EVIDENTIARY ISSUES

The defense strategy relied heavily on the proposed testimony of an expert witness, Professor Daniel Fischel, and classified information relevant to Qwest's business prospects and the defendant's state of mind. The district court excluded both, and on appeal the defendant asserts that these decisions are reversible error. We agree that the district court's exclusion of Professor Fischel's testimony was an error that requires a new trial. There was no error in excluding the classified information.

A. Expert Testimony

The Federal Rules of Criminal Procedure require a defendant under certain circumstances to provide to the government, upon request, "a written summary of any testimony that the defendant intends to use [at trial] under Rules 702, 703, or 705 of the Federal Rules of Evidence." Fed.R.Crim.P. 16(b)(1)(C). This includes

expert testimony. "The summary must describe the witness's opinions, the bases and reasons for these opinions, and the witness's qualifications." *Id.* The parties do not dispute that Rule 16 disclosure was required in this case.

On March 16, 2007, the defense disclosed its intention to call Professor Daniel Fischel to provide economic analysis of Mr. Nacchio's trading patterns, and to testify about the economic importance of the allegedly material inside information. The government objected that this notice was insufficient under Rule 16. The district court agreed, holding that the notice was in "plain violation of the Rules," because the defense had "offer[ed] no bases or reasons whatsoever for Professor Fischel's opinions contained in the summary." App. 352. The judge instructed the defense to file a revised disclosure, "bringing his submission into compliance with Rule 16," by March 26. *Id.*

In court on March 22, in the course of granting the defense three extra days to prepare a revised disclosure, the district judge commented that he was "flabbergasted, frankly, that [the defense] could think th[e first disclosure] was an adequate expert disclosure," and said: "I think [Rule 16] is pretty clear, and ... it's pretty close to what is required in the civil area." App.2038, 2041. The government's lawyer then added, "[I]t's my concern at least based on the way the disclosure is raised [sic] right now, there could be Daubert issues that arise with respect to certain parts of the testimony." *Id.* at 2041–42. "*Daubert*" is legal shorthand for the district court's obligation to test a proposed expert's methodology in advance of his

testimony.[3] Defense counsel responded: "In Latin, forewarned is forearmed." *Id.* The court then recessed.

On March 29, the defendant filed a revised, ten-page Rule 16 disclosure describing Professor Fischel's qualifications as an academic, his research and teaching in law and finance, and his previous experience consulting and testifying. It gave a "Summary of Opinions and Bases for Opinions," explained that Fischel had conducted a "study of the Questioned Sales in relation to various benchmarks," and provided his consequent opinion that Mr. Nacchio's sales were inconsistent with what one would expect them to be if the government's claims were true. App. 427–30. It recounted that Professor Fischel had studied stock data and assorted public information and stock analysis and had concluded that Qwest's stock price was not significantly affected when the allegedly material information was released.

On April 3, the government filed a 63–page motion to exclude Professor Fischel's testimony. The government's main argument was that the Rule 16 disclosure was still inadequate. It also argued, however, that "[e]ven if the Court determines that the disclosure was adequate, the Court should rule that Defendant has not established its admissibility" under, among other things, *Daubert*. App. 420. The next day,

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[3] *See Daubert v. Merrell Dow Pharms.*, 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993) (requiring expert testimony to be pursuant to a reliable methodology). As the district judge noted, *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 119 S.Ct. 1167, 143 L.Ed.2d 238 (1999), may actually be the governing case. The parties used "*Daubert*" as shorthand for these doctrines and so will we.

April 4, the defendant filed a seven-page response. He argued that the disclosure was adequate for Rule 16 purposes, that Professor Fischel's opinions would "assist the trier of fact," as Rule 702 requires, and that Professor Fischel's qualifications in "the economics of financial markets" were adequate. App. 466, 468. The response made no mention of Professor Fischel's methodology, or of *Daubert*.

The next day, April 5, trial resumed and the defense called Daniel Fischel to the stand. Without either party saying anything, the judge interjected, "All right. Members of the jury, I need to make some legal rulings at this time," and dismissed the jury. App. 3913. Without hearing from counsel for either party, the judge then ruled that Professor Fischel's expert testimony was inadmissible, explaining himself at length. The judge said that "the deficiencies under Daubert and Kumho Tire in these disclosures are so egregious that they hardly warrant the 63 pages of ink the Government has spilled in opposing the testimony." App. 3914. The judge noted that Professor Fischel's "methodology [was] absolutely undisclosed in this expert disclosure." App. 3917. After criticizing the Rule 16 disclosure's failure to address methodology, the Court also separately concluded that the testimony would not be helpful to the jury under Federal Rule of Evidence 403 or 702, because expert economic analysis would "invit[e] the jurors to abandon their own common sense and common experience and succumb to this expert's credentials," App. 3920, and concluded that "the bulk of [Fischel's] testimony is simply a recitation of facts which is improper under Rule 602." *Id.* He then asked the defense to call a new witness.

After the judge's ruling, the defense spoke for the first time since attempting to call Professor Fischel:

> MR. SPEISER: Your Honor, may I be heard?
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> THE COURT: No. You know, in this court, we follow, the rule, generally, that we have argument and ruling. Not, the Court rules, and then it's an interactive process where you get to argue later on. I have your motion, I have the Government's motion, I have your response. Any argument that you wish to make could have been put in the response.
>
> MR. SPEISER: We were under tremendous time pressure.
>
> THE COURT: So what? You could have put it in the response. You have made your record. You have made your argument. I've ruled. This habit that the defense has of questioning every ruling by argument later on is not going to be tolerated in this court.

App. 3921. The government had not spoken at all. The defense then called Professor Fischel as a non-expert witness. He was permitted to give summary testimony about the facts of Mr. Nacchio's trades, without any economic analysis.

We conclude that on the record before him the district judge was wrong to prevent Professor Fischel from providing expert analysis, and that this error was not harmless.

1. Rule 16

The defendant's disclosures did not have the "egregious" "deficiencies" that the district court described. App. 3914. Rule 16 requires a defendant wishing to call an expert witness to disclose, in some

circumstances, "the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications." Fed.R.Crim.P. 16(b)(1)(C)(i). The district court's belief that Rule 16 also requires extensive discussion of a witness's methodology was incorrect, and its exclusion of the evidence an abuse of discretion.[4]

Rule 16 is designed to give opposing counsel notice that expert testimony will be presented, permitting "more complete pretrial preparation" by the opposing side, Fed.R.Crim.P. 16, 1993 Advisory Comm.'s Notes, such as lining up an opposing expert, preparing for cross-examination, or challenging admissibility on *Daubert* or other grounds. Rule 16 disclosure is not designed to allow the district court to move immediately to a *Daubert* determination without briefs, a hearing, or other appropriate means of testing the proposed expert's methodology. *See* Margaret A. Berger, *Procedural Paradigms for Applying the* Daubert *Test*, 78 Minn. L.Rev. 1345, 1360 (1994) ("Although the summary required by Rule 16 provides the defense with some notice, the requirement of setting forth 'the bases and reasons for' the witnesses' opinions does not track the methodological factors set forth by the *Daubert* Court."). Indeed, a Rule 16 disclosure need not be filed with the court,[5] but only

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[4] At oral argument, the defendant appeared to argue that the Rule 16 disclosure did substantially discuss Professor Fischel's methodology. We agree with the district court's conclusion that it did not.

[5] Rule 16 requires only that the written summary be given "to the government," Fed.R.Crim.P. 16(b)(1)(C), and criminal discovery can generally "proceed without the district court's intervention" unless there is a dispute. *United States v. Mentz*,

with opposing counsel, which makes clear that it is not intended to serve as the basis for a judicial determination regarding admissibility. It also bears mention that a defendant is not required to file a Rule 16 disclosure unless the defendant has made a similar request of the government under Rule 16(a)(1)(G) and the government has complied. Obviously, this scenario does not preclude the government from challenging the defendant's proffered expert under *Daubert*. It is therefore a mistake to regard the Rule 16 disclosure as a substitute for a *Daubert* hearing.

The defendant's disclosure did exactly what the law required. Rule 16 requires, first, disclosure of "the witness's opinions." Fed.R.Crim.P. 16(b)(1)(C)(i). The government does not contest that the disclosure listed Professor Fischel's opinions on several topics, including whether Mr. Nacchio's trading pattern was suspicious, how Qwest stock prices related to the September 2000 guidance, and the magnitude and importance of the information Qwest had about its IRU revenue. Rule 16 requires next "the bases and reasons for those opinions." *Id.* The disclosure explained that the opinion was "based on" analysis of Mr. Nacchio's trades, data on stock prices, executive options, and stock sales; as well as on analysis of press reports, analysts' reports and forecasts, and SEC filings. It also contained the reasons for Professor Fischel's ultimate opinions. For example, he would have testified that principles of risk reduction and the pattern of Mr. Nacchio's sales were inconsistent with reliance on adverse material inside information, and that the

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840 F.2d 315, 328 (6th Cir.1988). The defendant's disclosure in this case was not filed with the court, but was attached to the government's subsequent motion to exclude the testimony.

September 2000 guidance was not misleading because Qwest's stock price fell after it was announced but not when that guidance was reduced in September 2001. Finally, Rule 16 requires disclosure of "the witness's qualifications." The defense disclosed Professor Fischel's work at Lexecon (a law-and-economics consulting firm), his academic positions, his academic research, his previous experience as an economic consultant and adviser, and his 25–page curriculum vitae. On multiple occasions, Professor Fischel had testified as an expert witness for the Department of Justice in finance cases.

We do not doubt that, in response to a Rule 16 disclosure statement, the district court could order a party to make a written proffer in support of admissibility under Rule 702. *See United States v. Rodriguez–Felix*, 450 F.3d 1117, 1122 (10th Cir.2006); *United States v. Rodriguez–Felix*, No. 04–CR–665 (D. N.M. filed Mar. 25, 2004), docket no. 76; *United States v. Sourlis*, 953 F.Supp. 568, 581 (D.N.J.1996). It does not much matter whether such additional detail is regarded as part of the Rule 16 "duty" to disclose, *see Sourlis*, 953 F.Supp. at 581, or as an exercise of the court's discretion in "deciding ... what procedures to utilize in making" the Rule 702 determination, as our precedent implies, *Rodriguez–Felix*, 450 F.3d at 1122. We have found no case—and the government has cited none—where a defendant's proffered expert was excluded under *Daubert* solely on the basis of a Rule 16 deficiency, without any further opportunity of briefing or hearing.

The district court's error may have proceeded from confusion between the civil and criminal rules. Unlike under the civil rules, an expert in a criminal case is *not*

required to present and disclose an expert report in advance of testimony. A Rule 16 disclosure must contain only "a written summary of any testimony" and "describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications." Fed.R.Crim.P. 16(b)(1)(C). In contrast, an expert's written report in a civil case must include not only "a complete statement of all opinions the witness will express and the basis and reasons for them," Fed.R.Civ.P. 26(a)(2)(B)(i), and his qualifications, R. 26(a)(2)(B)(iv), but also all of the data or other information considered in forming the opinion, all summary or supporting exhibits, and the compensation he was paid. *Id.* R. 26(a)(2)(B)(ii)-(iii), (vi). Thus, the judge's comment that the criminal expert disclosure requirement is "pretty close to what is required in the civil area," App.2041, was not correct—one need only look at the text of the two rules to recognize the broader requirements of the civil rule. *See United States v. Mehta*, 236 F.Supp.2d 150, 155–56 (D.Mass.2002) (Gertner, J.) ("One way to decipher the meaning of the criminal expert discovery rules is to compare them to the civil discovery rules, which are much broader. While Fed.R.Civ.P. 26(a)(2) requires a 'complete statement' of the expert's opinion, the criminal rule requires only a 'summary of testimony.' Civil Rule 26(a)(2) additionally requires the disclosure of: 'all opinions to be expressed and the basis and reasons therefor'....").

The government argues that a Rule 16 disclosure should include sufficient information to meet the proponent's burden under *Daubert* because the goal of Rule 16 is "'to provide the opponent with a fair opportunity to test the merit of the expert's testimony

through focused cross-examination,'" Aplee's Br. 54 (quoting Fed.R.Crim.P. 16, 1993 Advisory Comm.'s Notes) and "[t]he prosecution could hardly test an undisclosed methodology." *Id.* at. 55. However, it is not true that the prosecution had no way to test Fischel's methodology if it did not appear in a Rule 16 disclosure, just as it could have tested his methodology if there had been no disclosure at all (as Rule 16 contemplates in some cases). The prosecution had every right to demand a *Daubert* hearing to test his methodology. The court also may have had discretion to order a *Daubert* proffer in advance of any such hearing. Other courts have sometimes relied on this purpose of the rule to excuse disclosing *less* than Rule 16 requires. *E.g., United States v. Cuellar*, 478 F.3d 282, 294 (5th Cir.2007) ("Although the notice provided by the government did not contain all the detail required by the rule ... [t]he purposes of Rule 16 were not frustrated."), *cert. granted on other grounds*,— U.S. —, 128 S.Ct. 436, 169 L.Ed.2d 304 (2007). We have found no case requiring *more*. The defense complied with Rule 16, and that gave the government all the "fair opportunity" for cross-examination that the rule contemplates.

2. ***Daubert***

Even if there was no Rule 16 violation, the government contends, the district court properly excluded the testimony under *Daubert* and Rule 702. We cannot agree.

Most importantly, the district court made no genuine determination of any sort under *Daubert*. The most straightforward reading of the transcript is that the judge excluded the evidence on Rule 16 grounds alone. It was "the deficiencies under Daubert and

Kumho Tire *in these disclosures*" that the district court found "egregious." App. 3914 (emphasis added). At the conclusion of its discussion of *Daubert*, the court repeated that it was "concerned ... with the methodology, which is absolutely undisclosed *in this expert disclosure*." App. 3917 (emphasis added). It is true that the court repeatedly discussed what *Daubert* requires of an expert, but only in explaining what was missing from the Rule 16 disclosures. As we have discussed, a Rule 16 disclosure need not provide a full explanation of the witness's methodology, so it is wrong to demand that such a disclosure satisfy *Daubert*.

Even reading the district court's ruling as a freestanding *Daubert* ruling rather than a finding that the Rule 16 disclosure was inadequate,[6] such a ruling would have been an abuse of discretion on this record, which is devoid of any factual basis on which a *Daubert* ruling could be made. In a criminal trial the proponent of expert testimony is not under any obligation to provide a "a complete statement" of the reasons for the expert's opinion, *compare* Fed.R.Civ.P. 26(a)(2)(B)(i), or an explanation of the expert's methodology. In the absence of a court ruling that the *Daubert* issue be addressed and resolved in some other way, the first order of business upon presenting the expert in court would be to establish his qualifications and the

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[6] *See Sprint/United Management Co. v. Mendelsohn*, 552 U.S. —, 128 S.Ct. 1140, 1145, 170 L.Ed.2d 1 (2008) ("An appellate court should not presume that a district court intended an incorrect legal result when the order is equally susceptible of a correct reading."). We do not believe the district court's ruling is "equally susceptible" to the alternative reading, but we do not entirely rule it out.

admissibility of his testimony, either through written submissions or by asking the necessary questions and allowing the other side to cross-examine or introduce evidence challenging the basis for his testimony. This could take place outside the presence of the jury. The district court could not make an informed *Daubert* determination without hearing such testimony or receiving submissions on the issue in some other form.

When district judges *admit* testimony under *Daubert* we require them to make "specific findings on the record" rather than rule "off-the-cuff." *Dodge v. Cotter Corp.*, 328 F.3d 1212, 1223 (10th Cir.2003) (quoting *Goebel v. Denver & Rio Grande W.R.R.*, 215 F.3d 1083, 1088 (10th Cir.2000)) (internal quotation marks and emphasis omitted). We also require the court to create "a sufficiently developed record in order to allow a determination [on appeal] of whether the district court properly applied the relevant law." *Goebel*, 215 F.3d at 1088 (quoting *United States v. Nichols*, 169 F.3d 1255, 1262 (10th Cir.1999)) (internal quotation marks and further citation omitted). Although "rejection of expert testimony is the exception rather than the rule," Fed.R.Evid. 702, 2000 Advisory Comm.'s Notes, we have not had occasion to decide whether the same procedural requirements apply before a judge excludes an expert. We need not resolve that issue here, because we conclude that at a minimum it is an abuse of discretion to exclude an expert witness because his methodology is unreliable without allowing the proponent to present *any* evidence of what the methodology would be. The proponent bears the burden of establishing the admissibility of the evidence under Rule 702, but it

must be given an opportunity to do so before the testimony may be ruled inadmissible.

Finally, the government argues that we should affirm Professor Fischel's exclusion because the defense failed to respond to the *Daubert* issue in its April 4 response, and thus waived the right to do so. We do not agree. The defense had only one day to respond to the government's 63–page motion, and did not have clear notice that it had to present its *Daubert* defense at that time. The judge's ruling on the first Rule 16 disclosure, which set the exchange of motions and replies going, mentioned "Federal Rules of Evidence 401, 403, 602, 702, and 704," but held that "[t]he matter may be settled through analysis under Rule 16." It made no mention of *Daubert*. The defendant complied by providing an analysis under Rule 16. App. 351. Only then did the government file its lengthy motion, which combined an argument that Rule 16 requires disclosure of methodology with an attack on the witness's methodology under *Daubert*. The defendant may reasonably have interpreted the references to *Daubert* as arguments about Rule 16, as a request for a *Daubert* hearing, or perhaps as notice that the government intended to move for such a hearing. The defendant had no reason to think that the *Daubert* issue would be resolved on the basis of memoranda of law addressed to the Rule 16 issue, which is not the usual procedure. We give district judges "broad discretion ... in deciding ... what procedures to utilize" to assess reliability, *Dodge*, 328 F.3d at 1223, but it is for this reason that parties cannot be held to guess the procedural rules in advance. Courts should not punish parties for guessing wrong,

especially with the extreme sanction of excluding evidence central to the defense.

Finally, the defense was never permitted to speak to the issue in court. When Professor Fischel was called, the district judge immediately announced that he was excluding the testimony. A defense lawyer asked to speak. The judge silenced him immediately, saying that once the court had ruled, the trial was "[n]ot ... an interactive process where you get to argue later on." App. 3921. When the court does not allow a lawyer to present arguments, we will not penalize him for failing to present them.

A judge does not necessarily have to let lawyers "argue later on," but he has to let them argue *sometime*. Our decision in *United States v. Rodriguez–Felix*, 450 F.3d 1117 (10th Cir.2006), illustrates the point. In *Rodriguez–Felix*, the defendant wished to call an expert to testify about the reliability of eyewitness testimony. Because the Rule 16 notice (naturally) did not disclose the expert's methodology, the district court scheduled a *Daubert* hearing, and also ordered the defendant to submit a specific proffer on the *Daubert* issue. *United States v. Rodriguez–Felix*, No. 04–CR–665 (D. N.M. filed Mar. 25, 2004), docket nos. 75, 76. When the expert did not attend the hearing, the district court then considered the *Daubert* proffer alone, and excluded the testimony because the proffer was insufficient. *See Rodriguez–Felix*, 450 F.3d at 1125–27. In Mr. Nacchio's case, the defense was given no similar opportunity to present evidence.

As the judge explained later that morning, the trial was on track to finish "way ahead of time." App. 3942. The jury was out of the room. Indeed, the jury was soon dismissed for the rest of the day because the

surprising exclusion of Professor Fischel threw the parties' lawyers into disarray. The judge could have put Professor Fischel on the stand to ask him about his methodology, allowed the government to do so, asked Mr. Nacchio's lawyers if they would like to address the issue for the first time, or even simply let them speak to see if they had a meritorious objection. Having permitted none of those things, however, it would have been an abuse of discretion to make a *Daubert* finding of unreliability.

3. Rules 403 and 602

While the district judge excluded Professor Fischel "primarily [for] the gross defect" in the Rule 16 disclosure, App. 3921, he also excluded the expert testimony because he thought it would not be helpful to the jury, was more prejudicial than probative, and consisted of impermissible facts rather than opinions. *See* Fed.R.Evid. 403, 602, 702. We reverse these alternative conclusions as well.

Professor Fischel's testimony was to include a discussion of the economic incentives that inside information would have given Mr. Nacchio, the statistical significance of the differences in his trading patterns, and the likelihood that economic diversification better explained the challenged sales than inside information. The judge concluded that all of these things were "within the common knowledge of the jury" and that "[t]he jury simply d[id]n't need this so–called expert witness to testify that diversification is an issue in this case." App. 3918-19. This misunderstands the nature of economic expertise. An economic expert is permitted not only to tell the jury that an economic concept "is an issue" but to analyze the concept and offer informed opinions. In other

words, expert testimony may "assist the trier of fact to understand the facts already in the record, even if all it does is put those facts in context." 4 Jack B. Weinstein & Margaret A. Berger, *Weinstein's Federal Evidence* § 702.03[1] (2d ed.2006) (footnote omitted). That is why expert economic testimony is routine when a materiality determination requires the jury to decide the effect of information on the market. *See, e.g.*, 3 Alan R. Bromberg & Lewis D. Lowenfels, *Bromberg and Lowenfels on Securities Fraud & Commodities Fraud* § 6:153 (2d ed.2007). While economic analysis sometimes asks jurors to "abandon their own common sense," App. 3920, that is not a reason to deem expert testimony inadmissible. Armchair economics is not the way to decide complex securities cases.

The district court's holding that the testimony was inadmissible under Rule 403 suffers from the same problem. The court's analysis on the point was very brief, and mostly dependent on the conclusions we have already rejected.

Finally, the district court was wrong to conclude that it was "perfectly obvious" that Professor Fischel did not have personal knowledge of the facts that formed the basis for his opinions. App. 3921. The judge said that Professor Fischel did not have personal knowledge of Qwest's stock price, of the contents of analysts' reports, or of the guidance issued by other telecommunications companies. But Professor Fischel's expert disclosure—which is all the court consulted—said that he and his staff "ha[d] reviewed" Qwest's stock prices, the analysts' reports, and so on. App. 433. This is personal knowledge; it is not clear what more the district judge demanded. In *Bryant v. Farmers Ins. Exch.*, 432 F.3d 1114 (10th Cir.2005), we

held that Rule 602 permitted a lay witness to testify about the contents of a list of audit reports. As we explained, "[s]ince [the witness] personally examined these audit reports, she had personal knowledge of their content." *Id.* at 1123. Apart from potential hearsay objections, Professor Fischel would have been perfectly entitled to testify about facts in the reports, even as a lay witness.

Moreover, we have also held that "[t]he standards [of personal knowledge] applied to lay and expert witnesses differ." *Durflinger v. Artiles*, 727 F.2d 888, 892 (10th Cir.1984). In particular, Rule 703" permits an expert to base an opinion on any facts or data, *admissible or not*, which are of a type reasonably relied on by experts in the particular field ...." *Id.* (emphasis added) (internal quotation marks and citation omitted). Because using stock prices and information issued by various companies is a common and reasonable way for an economist to analyze the impact of that information on the stock prices, there was no basis for excluding his testimony about stock price.

4. Prejudice

The government contends that even if the exclusion of Professor Fischel was error, it was harmless. We disagree.

The right of a defendant to call witnesses is crucial for testing the prosecution's case and defeating the charges against him. Indeed, the "right to present a defense ... is a fundamental element of due process of law." *Washington v. Texas*, 388 U.S. 14, 19, 87 S.Ct. 1920, 18 L.Ed.2d 1019 (1967). Even if the exclusion does not rise to the level of a constitutional violation, the burden is on the government to prove that the error did not have "a 'substantial influence' on the

outcome." *United States v. Rivera*, 900 F.2d 1462, 1469 (10th Cir.1990) (en banc) (quoting *Kotteakos v. United States*, 328 U.S. 750, 765, 66 S.Ct. 1239, 90 L.Ed. 1557 (1946)).

We are persuaded that the exclusion of Professor Fischel was not inconsequential under any standard. The theory of Mr. Nacchio's defense was that the stock price was not affected by his disclosures, that his conduct had an innocent explanation, and that a reasonable investor would not have found his inside information very important. Professor Fischel's testimony, as described in the disclosure, could have addressed each of these issues, and if credited by the jury, might have changed the jury's mind. The record does not otherwise contain "overwhelming evidence of guilt," *United States v. Montelongo*, 420 F.3d 1169, 1176 (10th Cir.2005), and so we cannot say the exclusion was harmless.

B. Classified Information

Mr. Nacchio also argues that the district court was wrong to prevent him from presenting certain classified information as evidence at trial. He claims that the evidence would have shown that he personally had reason to believe that Qwest's economic prospects were much better than others realized. Thus, he says, this evidence should have been permitted both to show that he did not have material information and to negate scienter. We affirm the district court's decision, because even if the classified information were presented and established what he said it would, it could not exonerate Mr. Nacchio as he claims.

Essentially, Mr. Nacchio argues that undisclosed positive information can be used as a defense to a charge of trading on undisclosed negative information.

We disagree. If an insider has material information that he cannot disclose because it is confidential or proprietary, then he must abstain from trading. That is the lesson of *In re Cady, Roberts & Co.*, Exchange Act Release No. 6,668, 40 S.E.C. 907, 911 (1961), later applied in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848, 850 n. 12 (2d Cir.1968), and *Chiarella v. United States*, 445 U.S. 222, 226–29, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980). It is black-letter law that insiders must disclose their material information or else abstain.

It is true that in cases like *Texas Gulf Sulphur*, insiders were trading in bullish positions ahead of the disclosure of the company's proprietary discovery, and thus their trading correlated with the inside information, while here Mr. Nacchio argues that his possession of classified information neutralizes his possession of other inside information. However, the general rule applies. If an insider trades on the basis of his perception of the net effect of two bits of material undisclosed information, he has violated the law in two respects, not none.

III. SUFFICIENCY OF THE EVIDENCE

Although we have concluded that Mr. Nacchio's conviction must be reversed on account of trial error, we cannot leave it at that. He also claims that the government failed to introduce evidence sufficient for him to be convicted. If he is right, he was entitled to a judgment of acquittal and cannot be retried without violating the Double Jeopardy Clause. *See Anderson v. Mullin*, 327 F.3d 1148, 1155 (10th Cir.2003). An analysis of sufficiency of the evidence is not merely a technical matter, but can require resolution of important questions regarding the elements of the

offense. Under one interpretation of a penal statute the evidence may be sufficient, while under a different interpretation it may fall short. We must therefore examine the government's theory of the case and determine what is needed to support a conviction for insider trading in this context.

Mr. Nacchio also challenges certain of the jury instructions, which presented the government's theory of the case to the jury and framed its considerations of the evidence. If he is right regarding those challenges, and if the error is not harmless, this would constitute an additional ground for reversal, though it would not preclude retrial. But if the evidence introduced at trial is insufficient to support conviction under a correct theory of the case, he is entitled to a judgment of acquittal. The jury instructions question and the sufficiency-of-the-evidence question are interrelated: when asking what facts the jury had to find in order to convict, we look to the elements of the crime as defined by law, except that if the government did not object to jury instructions containing additional requirements, it is required to prove those too. *See United States v. Romero*, 136 F.3d 1268, 1271–73 (10th Cir.1998).

Our review is narrow in scope. With respect to jury instructions, we can consider only objections to the accuracy of instructions that were raised before the trial court (or constitute plain error—which we do not find here) and with respect to the refusal of the district court to issue other instructions, we are limited to those actually requested by a party. *United States v. Crockett*, 435 F.3d 1305, 1314 (10th Cir.2006). Moreover, on a sufficiency challenge, we must view the evidence in the light most favorable to the government, and reverse only if no rational jury could have found

the evidence sufficient to convict beyond a reasonable doubt. *United States v. Brown*, 200 F.3d 700, 704-05 (10th Cir.1999). This is a highly deferential standard.

Mr. Nacchio was convicted under 15 U.S.C. §§ 78j, 78ff, and 17 C.F.R. §§ 240.10b–5, and 240.10b5–1. These statutes delegate the power to define criminal liability to the Securities and Exchange Commission by forbidding anyone from willfully using, "in connection with the purchase or sale of any security, ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. § 78j(b). Those rules and regulations in turn prohibit trading a security "on the basis of material nonpublic information about that security ... in breach of a duty of trust or confidence." 17 C.F.R. § 240.10b5–1(a). In other words, it is a crime for a corporate insider to "trade [ ] in the securities of his corporation on the basis of material, nonpublic information." *United States v. O'Hagan*, 521 U.S. 642, 651–52, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997).

Mr. Nacchio challenges his conviction in three different respects. First, he argues that the undisclosed information on which he was alleged to have traded was not material. Second, he argues that he did not act with willful intent. Third, he argues that, as a matter of law, even if the information he had was material it was not a factor in his decision to trade. In explaining why these challenges fail, we will first examine the instructions the jury was given on each legal issue—materiality, scienter, and the connection of the inside information to the trades—and provide our interpretation of the governing law. Then we will explain why the government's evidence was enough

that a properly-instructed jury could have found Mr. Nacchio guilty.

A. Materiality

The prohibition against insider trading applies only to those who trade on the basis of material undisclosed information. The parties do not contest that the basic test for the materiality of inside information is whether there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). The Supreme Court has stated that this inquiry is "fact-specific" and "depends on the significance the reasonable investor would place on the withheld ... information." *Basic Inc. v. Levinson*, 485 U.S. 224, 240, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988). Essentially, "materiality will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Id.* at 238, 108 S.Ct. 978 (internal quotation marks omitted). That is, information about future events is material if—taking into account both the probability of those events and their potential importance—a reasonable investor would regard the information as "significantly" different from the information already made public.[7] Corporate insiders must disclose what material nonpublic information they possess or else to abstain from trading. *See Chiarella*

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[7] Both *Basic Inc.* and *TSC Industries* were civil cases, but the Court refused to "vary[ ] the standard of materiality depending on who brings the action or whether insiders are alleged to have profited." *Basic Inc.*, 485 U.S. at 240 n. 18, 108 S.Ct. 978.

v. United States, 445 U.S. 222, 226–29, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980).

1. Jury Instructions

We review "'the instructions as a whole de novo to determine whether they accurately informed the jury of the governing law.'" *United States v. McClatchey*, 217 F.3d 823, 834 (10th Cir.2000) (quoting *United States v. Cerrato–Reyes*, 176 F.3d 1253, 1262 (10th Cir.1999)). We then review any instructions offered by the defendant and rejected by the court. "A defendant is entitled to an instruction on his theory of the case if the instruction is a correct statement of the law, and if he has offered sufficient evidence for the jury to find in his favor." *Crockett*, 435 F.3d at 1314. We review a district judge's refusal to issue a requested instruction under this standard for abuse of discretion. *Id.* Unopposed instructions are reviewed only for plain error. *Medlock v. Ortho Biotech, Inc.*, 164 F.3d 545, 553 (10th Cir.1999).

In light of the fact-specific nature of the materiality determination it is important to give a jury enough guidance to sort out material information from noise. It is difficult for untrained jurors to judge *ex post* what would have been important to reasonable investors *ex ante*. After the fact, whenever anybody has made money trading stock it is easy to say that one would have wanted to know whatever the trader knew.

Here, the district court orally instructed the jury as follows:

> "Material," in order to—for you to find a material matter or a material omission, the Government must prove beyond a reasonable doubt that the matter misstated or the matter omitted was of such importance that it could reasonably be

expected to cause a person to act or not to act with respect to the securities transaction at issue.

Information may be material even if it relates not to past events, but to forecasts and forward-looking statements, so long as a reasonable investor would consider it important in deciding to act or not to act with respect to the securities transaction at issue.

The securities fraud statute under which these charges are brought is concerned only with such material misstatements or such material omissions and does not cover minor or meaningless or unimportant matters or omissions.

So the test is whether the matter misstated or the matter omitted was of such importance that it could reasonably be expected to cause a person to act or not to act with respect to the securities transaction at issue.

App. 4558-59.

We recognize that these instructions were adapted from a pattern instruction, *see* Kevin O'Malley, Jay Grenig & William Lee, *Federal Jury Practice & Instructions*, § 62.14 (5th ed.2000), but they are not particularly informative. On appeal, the defendant suggests that the instructions should have incorporated the concepts of probability and magnitude, *see Basic, Inc.*, 485 U.S. at 238, 108 S.Ct. 978, and "total mix," *TSC Indus.*, 426 U.S. at 449, 96 S.Ct. 2126, to further illuminate the concept of materiality, but he did not request such instructions when he had a chance in trial court to do so. Nor did he request any instruction informing the jury of the SEC's regulatory guideposts regarding materiality. The question before us is therefore whether the

instructions Mr. Nacchio did receive misstated the law. They did not. The Supreme Court has said that the "significance the reasonable investor would place on the withheld ... information," is the test for materiality, *Basic Inc.*, 485 U.S. at 240, 108 S.Ct. 978, and that is what the jury was instructed.

The defendant did request two instructions about materiality, but they were not "correct statement[s] of the law." *Crockett*, 435 F.3d at 1314. First, he requested an instruction about materially misleading forward-looking statements, based on the requirements of a different rule, Rule 10b–5. This Rule makes it a crime "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made ... not misleading ... in connection with the purchase or sale of any security." 17 C.F.R. 240.10b–5(b). The defendant proposed a jury instruction based on the theory that if the nondisclosure of information regarding the IRU sales did not render Qwest's public projections affirmatively misleading under Rule 10b-5, that information must not have been material for purposes of insider trading regulations.

Much of the instruction Mr. Nacchio proposed is simply confusing. For example, it would have provided: "A forward-looking statement of the type conveyed to the public by Qwest and Mr. Nacchio on or about September 7, 2000, cannot be considered by you to be 'material' under the law unless it is shown that the statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." App. 755-56. But the materiality issue in the case was whether the *inside* information was material; nobody had attempted to deny that the public guidance

was material, and it is not clear what that would mean. Moreover, when public guidance is "made or reaffirmed without a reasonable basis" that does not mean the guidance is "material." *Id.* at 756. It means that the guidance is *misleading*. This nonsensical syntax alone would have been a valid reason to reject Mr. Nacchio's instruction.

The proposed instruction went on to state: "Even if some of [Qwest's] internal projections conflicted with its publicly-issued projections or guidance that information would not be considered material, and Qwest and Mr. Nacchio would only be required to disclose such tentative internal projections that conflicted with the published projections if the internal figures were so certain that they show the published figures to have been without a reasonable basis." *Id.* at 757. In support of this instruction, the defendant relies on a number of cases limiting liability for false statements of material fact to cases where those statements were made without a reasonable basis or in bad faith. We do not think those cases apply in this context.

The SEC has promulgated a rule, called Rule 175, specifically designed to provide a safe harbor for "forward-looking statement[s] ... filed with the [SEC]." Such a statement will "be deemed not to be a fraudulent statement ... unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." 17 C.F.R. § 230.175.[8] Until the adoption of Rule

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[8] Rule 175 applies to liability under the Securities Act of 1933; a second rule, 17 C.F.R. § 240.3b–6, provides identical protection from liability for misleading statements under the Securities

175, the SEC had discouraged firms from making future projections at all, and encouraged them to comment only on hard data about the present and past. Rule 175 was adopted to encourage companies to make estimates. Without it, as Judge Easterbrook has asked, "What's in it for them? If all estimates are made carefully and honestly, half will turn out too favorable to the firm and the other half too pessimistic. In either case the difference may disappoint investors, who can say later that they bought for too much ... or sold for too little...." *Wielgos v. Commonwealth Edison Co.* 892 F.2d 509, 514 (7th Cir.1989).

Mr. Nacchio is being prosecuted for concealing true information while trading, not for making misleading statements. Nonetheless, he argues that a similar safe harbor rule must extend to his actions. However, Rule 175 and the insider trading rules are conceptually distinct. The insider trading duty is to disclose *or* abstain. The "or" in this formulation implies there are cases where corporate officials are permitted not to disclose, so long as they refrain from buying or selling stock. The defendant's theory collapses the two: only when it would be affirmatively misleading not to disclose, he argues, may liability attach for failing to abstain. That is not the law. After all, Rule 10b–5 makes it a crime "to omit to state a material fact" *only* if that fact is "necessary in order to make the statements made ... not misleading." 17 C.F.R. 240.10b–5(b). This presupposes that it is possible for

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Exchange Act of 1934, the statute that also criminalizes insider trading.

omitted facts to be material even though the public statements do not mislead.[9]

The purpose of the reasonable basis principle reinforces our conclusion that it does not necessarily apply to insider trading cases, as opposed to false-statements cases. The rule exists to encourage companies to disclose estimates regarding future performance by protecting companies and their officers from liability so long as their estimates had a reasonable basis. But in an insider trading case, the reason to create a safe harbor for public statements—to encourage companies to make predictions—does not apply. Decreeing this information immaterial would mean that insiders could trade *without* disclosing it. This would turn the purpose of Rules 175 and 3b–6 on its head by sheltering those who keep predictions quiet, rather than rewarding them for disclosure. We are therefore not persuaded that the reasonable basis principle should apply to guard undisclosed information rather than disclosed projections.

The defendant also requested an instruction that if his public predictions and disclosures were "accompanied by warnings and cautionary language which provide the investing public with sufficiently specific risk disclosures," he could not be convicted. App. 758. This is known as the "bespeaks caution" doctrine, also borrowed from false-statements cases. *See Grossman v. Novell, Inc.*, 120 F.3d 1112, 1120 (10th Cir.1997). The defendant's argument to apply this doctrine to insider trading fails for the same reason as

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[9] For this reason, *Wielgos*, on which the defendant relies, is distinguishable: the defendant in *Wielgos* was charged with making false statements in its prospectus, not with insider trading.

his reliance on the reasonable-basis doctrine: it confuses the relationship of misleading public projections and material inside information.

The "bespeaks caution" rule is an application of the common-sense principle that the more a speaker qualifies a statement, the less people will be misled if the statement turns out to be false. Or as we put it in *Grossman*, "[a]t bottom, the 'bespeaks caution' doctrine stands for the 'unremarkable proposition that statements must be analyzed in context' when determining whether or not they are materially misleading." 120 F.3d at 1120 (quoting *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir.1994)). This rule does not apply here. First, there is no indication in the record that Qwest's public guidance and Mr. Nacchio's April 2001 reaffirmation of it to investors was so shrouded in cautionary language that the doctrine is applicable. Second, even if the public guidance were sufficiently hedged by cautionary language that the public knew to be wary of relying on it, this does not mean that the inside information on which Mr. Nacchio is alleged to have traded is immaterial. Certain and sure information that a company will experience a revenue shortfall might be material even if initial revenue projections had been expressed in cautious tones. Information is material if it adds materially to the mix of information already available to investors. *TSC Indus. v. Northway*, 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). That the information already made available was couched in warnings does not make new information (such as that IRUs constitute a dangerously high part of revenues and that opportunities for new IRU sales were drying up) immaterial. The issue in this case is not whether

Qwest's public guidance was materially misleading, but whether the undisclosed information on which Mr. Nacchio allegedly traded was material.

Whatever improvements might have been made in the instructions, the defendant was not entitled to the instructions that he asked for, and the instructions he ultimately received were not legally incorrect.

2. Sufficiency of the Evidence

Even if his legal theory of materiality is rejected, the defendant argues that the government failed to provide sufficient evidence that his information was "significan[t to] the reasonable investor." *Basic Inc.*, 485 U.S. at 240, 108 S.Ct. 978. As the government tells it, Mr. Nacchio knew in late 2000 that there were risks associated with his projections. If certain things went wrong, Qwest would not meet its public projections. By April 2001, Mr. Nacchio had learned that those things *had* gone wrong or at least were much more likely to. Mr. Nacchio responds that even if all of this is true, the total effect on Qwest's stock price would be too small to be significant as a matter of law.

Courts regularly look to the magnitude of a potential loss in determining whether knowledge of it is material. *See, e.g., City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1268 (10th Cir.2001) (refusing to allow a suit for failing to disclose a lawsuit whose threatened damages "totaled only 2.4%–3.5% of Fleming's total assets and approximately 10% of Fleming's total net worth"); *In re Apple Computer, Inc.*, 127 Fed.Appx. 296, 304 (9th Cir.2005) (unpublished) ("[Revenue] projections which are missed by 10% or less are not generally actionable."). But we have found no case that adheres rigidly to a mathematical threshold.

We take our cue from the SEC's guidelines for the materiality of errors in reported revenues. *See* Staff Accounting Bulletin No. 99, 64 Fed.Reg. 45,150 (1999). In that bulletin, the accounting staff applied the principles of *TSC Industries* and *Basic, Inc.*, to assess the common "rule of thumb" among accountants "that the misstatement or omission of an item that falls under a 5% threshold is not material in the absence of particularly egregious circumstances." *Id.* at 45,151 (footnote omitted). The staff blessed the rule of thumb so long as it was not used too rigidly:

> The use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that-without considering all relevant circumstances—a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material. The staff has no objection to such a "rule of thumb" as an initial step in assessing materiality. But quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations.

Id. Thus, a 5% numerical threshold is a sensible starting place for assessing the materiality of Mr. Nacchio's information about risks to Qwest's revenue guidance, but it does not end the inquiry. Special factors might make a smaller miss material. *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162–64 (2d Cir.2000) (holding on the basis of Staff Accounting Bulletin No. 99 that "numerical benchmark[s]" are informative but not the "exclusive" test).

The parties dispute the size of the potential shortfall predicted to Mr. Nacchio by Qwest staff in April, 2001. The defendant claims this figure is $300 million, or 1.4% of total revenues (as measured by the bottom of the range presented in the public guidance). The government contends the figure is $900 million, or 4.2% of total revenues. The dispute revolves around interpreting testimony given by Qwest's vice-president of financial planning, Robin Szeliga. She is the official who told Mr. Nacchio about the risks to the public projections. On direct examination, when she first discussed her December/January meeting with Nacchio, Ms. Szeliga testified that "we aggregated all the risk they were identifying, we were still at this time coming to a billion dollars of risk as it related to the target that we had set." App. 2134. This testimony was ambiguous because there were both public projections and internal targets, as mentioned above. Furthermore, in September when Ms. Szeliga had received the memo she was telling Mr. Nacchio about, the memo used estimates for the public guidance and internal targets that were different from the ones the company eventually set. In the memo, the internal target was predicted to be $22 billion (rather than 21.8) and the "street" target was to be $21.6 billion (rather than 21.3).

On cross-examination, Ms. Szeliga appeared to testify that she meant one billion dollars less than the internal target of $22 billion:

> Q. Okay. Now when you were talking about a billion dollar risk that all of these folks were debating and discussing, that was a billion dollar risk in their view at the time to the internal

> budget which was $21,991,000,000. That's true, isn't it?
>
> A. In the—yes, in the original, we showed that as it rounded up to $22 billion.

App. 2268. That testimony would support the defendant's $300 million figure, because $21 billion is $300 million less than the bottom of the public guidance. However, on re-direct examination, Ms. Szeliga corrected herself (without saying so), stating that the risk was closer to $1.2 billion and that it was against the public target at the time, not the private one:

> Q. [I]f you can highlight the 1,192,000,000, what does Mr. Bickley describe that as?
>
> A. Grand total risk in street disclosures, 1,192,000,000.
>
> Q. I'm going to round that to 1.2 billion; is that fair?
>
> A. Yes.
>
> Q. And I'm going to call that risk. So when I take the street, according to this memo, minus the risks, what do I come to?
>
> A. 20 billion .4.
>
> Q. 20.4 billion, all right. Street minus the risk is 20.4 billion. And I want to compare that to the guidance that Mr. Nacchio gave to the street two days after this, okay.
>
> A. Okay.
>
> Q. And how does this number, 20.4 billion, compare to the low end of the guidance that Mr. Nacchio disclosed to the street?
>
> A. About $900 million lower.

App. 2423–24.

For two reasons, we conclude that $900 million—the figure the government stressed in closing argument—is the one we must consider on appellate review. First, the memo itself explicitly refers to the $1.2 billion as a risk "in street disclosures," consistent with Ms. Szeliga's re-direct testimony. App. 4936. It is true that Ms. Szeliga testified that Mr. Nacchio never saw the memo, but she was talking to him about its contents, so it is helpful to compare her testimony to the document she was describing. Second, we are required to interpret the evidence in the light most favorable to the government. Given Ms. Szeliga's clarification on re-direct, the jury was entitled to believe that the higher figure was accurate.

Thus, we are asked to decide whether a risk that a company's revenue will fall $900 million short of its public guidance—a 4.2% shortfall—is necessarily immaterial to investors. Although it is a close question, we conclude that the answer is "no." The 4.2% shortfall is close to the 5% rule of thumb embraced by the SEC, and there was enough evidence of additional factors that we cannot reject the possibility of materiality as a matter of law. *See Ganino*, 228 F.3d at 162-64; Staff Accounting Bulletin No. 99, 64 Fed.Reg. 45,150 (1999). The government argued that the shortfall had particular salience given the state of the economy and the industry. Mr. Nacchio himself had said in January that the "skittish market" was so "mercurial" that even a $50 million shortfall could create a 15-20% drop in stock price. Aplee.'s Supp.App. exh. 559A. We think that if the evidence is viewed in the light most favorable to the government, a reasonable and properly-instructed jury could have concluded that

information about a 4.2% shortfall, in the special circumstances of this case, was material.[10]

Finally, Mr. Nacchio also points out that there is no evidence that Qwest's stock fell at the time when he released information about the IRUs. Ordinarily, that would be powerful evidence that the information was not significant to investors. But the government argues that this is because Mr. Nacchio "trickled out" the information so as to avoid a major market shock. Aplee's Br. 31. According to Lee Wolfe's testimony, before August some investors were already skeptical of Qwest's revenue because of the company's refusal to disclose information about IRUs. Then on August 7, Mr. Nacchio told investors in Boston that a disclosure about IRUs would be forthcoming. A week later, Qwest filed an SEC disclosure reporting how much of its revenue for the first two quarters came from one-time sources, and Mr. Wolfe testified that "investors were very surprised by the magnitude," notwithstanding that there had been "some disclosure after the first quarter." App. 1673. It also bears noting that Mr. Nacchio's million dollars in sales may have warned alert investors that prospects for the company were not as bullish as he was saying. From all of this, the jury could have concluded that Qwest's stock price incorporated the information in phases.

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[10] We do not disregard the other component of materiality analysis with respect to forward looking statements, which is the probability that the event will occur. *See Basic, Inc.*, 485 U.S. at 238, 108 S.Ct. 978. But in this case the parties have focused solely on the magnitude of the shortfall, should it occur. *See* Aplt's Br. at 24 (arguing that the risk was too small to be material "[e]ven if the jury thought that 'risk' was a *certainty*").

Thus, the evidence the government produced at trial was enough for a reasonable jury, properly instructed, to find Mr. Nacchio's information to be material.

B. Scienter

In addition to arguing that the information he possessed was not material, Mr. Nacchio argues that he traded in good faith and did not "willfully" violate the law, as the statute requires. 15 U.S.C. 78ff(a).

1. Jury Instructions

The district judge charged that:

> [T]he defendant must have committed these acts willfully, knowingly and with the intent to defraud.
>
> I will now define what I mean by these terms.
>
> An intent to defraud or an intent to deceive, manipulate or defraud is established if the Government proves beyond a reasonable doubt that the defendant acted knowingly with the intention or purpose to deceive or cheat.
>
> To act willfully means to act voluntarily and purposefully with the specific intent to do something which the law forbids. That is to say, with bad purpose, to disobey, or disregard the law.
>
> The term "knowingly" as used in these instructions to describe the alleged state of mind of the defendant means that he was conscious and aware of his action, realized what he was doing or what was happening around him, and did not act because of ignorance or mistake or accident or carelessness.
>
> The good faith of the defendant is a complete defense to the charge of securities fraud contained in each count of this Indictment because good faith

on the part of the defendant, if it is found by the jury, is simply inconsistent with the intent to defraud alleged in each charge of the Indictment.

A person who acts on a belief or an opinion honestly held is not punishable under this statute merely because the belief or opinion turns out to be inaccurate, incorrect or wrong. An honest mistake in judgment does not rise to the level of criminal conduct.

A defendant does not act in good faith if even though he honestly holds a certain opinion or belief if he also knowingly employs a device, scheme or artifice to defraud.

The law is written to subject criminal punishment only those [sic] people who knowingly defraud or attempt to defraud.

While the term "good faith" has no precise definition, it encompasses among other things a belief or opinion honestly held, an absence of an intention to defraud, and an intention to avoid taking unfair advantage of another.

The burden of proof is not on Mr. Nacchio to prove his good faith since the defendant has no burden to prove anything.

Rather, the Government must establish beyond a reasonable doubt the opposite of bad [sic] faith. That is, he acted with the intent to defraud charged in the Indictment.

If the evidence in the case leaves you with a reasonable doubt as to whether Mr. Nacchio acted with the intent to defraud or in good faith, then you must acquit him.

App. 4560–62.

This instruction defines the word "willfully" as "the specific intent to do something which the law forbids. That is to say, with bad purpose, to disobey, or disregard the law." *Id.* at 4560. The government objected that this instruction was too generous to Mr. Nacchio, arguing that the court should apply the standard used by the Supreme Court in interpreting a firearm licensing statute: "As a general matter, in the criminal context, a 'willful' act is one undertaken with a 'bad purpose.' In other words, in order to establish a 'willful' violation of a statute, the Government must prove that the defendant acted with knowledge that his conduct was unlawful." *Bryan v. United States*, 524 U.S. 184, 191–92, 118 S.Ct. 1939, 141 L.Ed.2d 197 (1998) (internal quotation marks and footnote omitted). We need not decide which version of this instruction is a more accurate interpretation of 15 U.S.C. § 78ff, because Mr. Nacchio does not challenge the instruction and the evidence was sufficient to convict him under either version.

Mr. Nacchio does challenge the portion of the instruction that discusses good faith, however. The instruction states that having good faith makes one innocent of insider trading, but that knowingly engaging in insider trading negates good faith. This may sound circular, but it expresses an important point. If the defendant was simply too bullish about Qwest's prospects, this does not make him guilty of insider trading; however, if he knew that he was more optimistic than the market, and that the market would devalue Qwest stock if it knew what he knew, he is not exonerated by his bullishness.

The defendant complains that the jury was misled by this sentence of the good-faith instruction: "A

defendant does not act in good faith if even though he honestly holds a certain opinion or belief if he also knowingly employs a device, scheme or artifice to defraud." App. 4561. He claims that the instruction allowed the jury to conclude that Mr. Nacchio acted in bad faith on the basis of dishonesty totally unrelated to the crime he was charged with. But the judge also charged the jury that "[a]n intent to defraud or an intent to deceive, manipulate or defraud" discussed in the good-faith instruction was relevant because "the defendant must have committed *these acts* willfully, knowingly and with the intent to defraud." *Id.* (emphasis added). Therefore, while they might have been clearer, the bad-faith instructions were limited to the crimes charged and did not allow the jury to hold Mr. Nacchio accountable for irrelevant conduct.

2. Sufficiency of the Evidence

The evidence at trial was enough for the jury to infer that Mr. Nacchio acted with the purpose to disobey the law or the knowledge that he was doing so. Lee Wolfe testified about a conversation he had with Mr. Nacchio regarding "the impact of disclosure of the use of one-timers" on the market. App. 1653. He testified that he and Mr. Nacchio discussed that "[t]he likely reaction was that ... [analysts] would be surprised at the magnitude of the transactions, and that the stock price would go down some amount." *Id.* In addition, Mr. Wolfe testified that when Qwest ultimately decided to lower its public guidance, Mr. Nacchio and Drake Tempest agreed that "there needed to be enough time" between the lowering of the guidance and the IRU disclosures Mr. Nacchio had made in August. *Id.* at 1677. This was "to give the sense that this was something new that caused the

lowering of the targets ... so that investors would accept the notion that lowering the targets was something that ... Mr. Nacchio would not have reasonably known when he made the statements in Boston." *Id.* at 1677–78. This can be interpreted as an effort to conceal the importance of the IRU information. Finally, the jury heard this testimony from Mr. Wolfe on cross-examination:

> Q. Now, what did Mr. Nacchio tell you in response to your concerns that were raised by the analysts about these one-time transactions? What was his response to you?
>
> A. Well, as I testified earlier, there were different responses in terms of what the impact on the stock price would be. A couple of other times he would say, you know, why do they need to know? And I would say, to make an informed decision whether to buy or sell the stock. And basically, he responded, screw them, go tell them to buy.

App. 1798–99. The jury was entitled to believe Mr. Wolfe and to conclude from his testimony that Mr. Nacchio knew that the information he had was material to the market.

As general counsel, Mr. Tempest approved Mr. Nacchio's sales plans in February and May of 2001, and determined that they were consistent with the company's insider trading policy. The jury convicted Mr. Nacchio of his trades executed pursuant to the May but not the February plan. Mr. Nacchio argues that he should have also been acquitted of his trades under the May plan because Mr. Tempest's approval of the plan constituted evidence that Mr. Nacchio did not willfully break the law. However, based on the

evidence that Tempest and Nacchio discussed concealing the importance of the IRUs, the government argued that the jury should discredit his approval. Mr. Tempest did not testify. A reasonable jury could believe that Mr. Tempest's signature was not conclusive evidence of Mr. Nacchio's good faith. The defense was permitted to put its argument regarding Tempest's approval to the jury; it was not entitled to judgment as a matter of law. Further, a reasonable jury could believe that by the time Mr. Nacchio entered into the May plan, his scheme to defraud investors had already begun and Mr. Nacchio's use of the May plan, notwithstanding Mr. Tempest's approval of it, was thus part of an attempt to conceal that scheme.

C. Trading on the Basis of Inside Information

Finally, Mr. Nacchio also argues that because he had an innocent explanation for his trades, the jury could not have concluded that his trades were "on the basis of" inside information. 17 C.F.R. § 240. 10b5-1 (a).

1. Jury Instructions

Over the government's objection, the judge charged the jury:

> A person trades on the basis of inside information if the Government proves beyond a reasonable doubt that the person actually used material non-public information in deciding to trade. It is not sufficient for an insider merely to have possessed the material non-public information when he traded.
>
> The inside—the test here is really one of cause. The inside information need not have been the sole cause of the trade. There may be other causes for the trade as well. It is sufficient that the inside

> information was a significant factor in an insider's decision to sell stock. A significant factor.

App. 4559.

This instruction was arguably incorrect because it was too favorable to Mr. Nacchio. Since 2000, Rule 10b5–1 has provided that an insider trades "on the basis of" information so long as he is "aware" of it, 17 C.F.R. § 240.10b5–1(b), unless he falls into one of the rule's safe-harbors—the creation of an automatic trading plan or some other binding contract or election to sell stock in advance of acquiring the information. *Id.* § 240.10b5–1(c). This would make Mr. Nacchio liable even if he could prove that he had unrelated reasons for his sales (such as the need to dispose of options before their expiration date) and thus that he did not trade "on the basis of" the information. In overruling the government's objection to the "significant factor" and "actually used" requirements, the district judge relied on the Ninth Circuit's decision in *United States v. Smith*, 155 F.3d 1051, 1067 (9th Cir.1998), which was decided before Rule 10b5–1 was enacted. When the government pointed out that *Smith* did not apply because "it precedes the rule in issue in this case," the judge responded, "I don't think it makes any difference. I think it's still good law," providing no further explanation. App. 4165–66.

By so ruling, the district court may have implicitly held that Rule 10b5–1 is not a lawful interpretation of the securities laws, at least if it means, as it appears to say, that the affirmative defenses it gives to awareness liability are exclusive. The statute under which insider trading is prosecuted is limited to "manipulative or deceptive" conduct. 15 U.S.C. § 78j(b). Some commentators maintain that the Rule (the authority of

which has not been resolved by any circuit) is unlawful because it effectively eliminates fraud from the liability standard. *See* Carol B. Swanson, *Insider Trading Madness: Rule 10b5–1 and the Death of Scienter*, 52 U. Kan. L.Rev. 147 (2003). However, on appeal, Mr. Nacchio has not attempted to defend the judge's instruction on this unarticulated ground, so we assume, without deciding, that Rule 10b5–1 is lawful.[11] If so, then the district court's instruction was more generous than Rule 10b5–1 provides.

Thus, the government's objection below to the court's instruction is significant for our analysis of the sufficiency of the evidence. When conducting such analysis, we normally look to what the law actually requires rather than what the jury was instructed so long as the government objected to the instruction below. *United States v. Williams*, 376 F.3d 1048, 1051-52 (10th Cir.2004). In this case, however, the government's proffered instruction said that the jury must find that the information was "a factor, however small, in the insider's decision to buy or sell." App. 743. Mr. Nacchio argues that because the government proffered this instruction, it must be held to no less stringent a standard on review of sufficiency of the evidence. It is not clear to us that the government

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[11] Mr. Nacchio submitted a proposed jury instruction more favorable than the one he received. In a footnote to that submission, he suggested that Rule 10b5-1 was invalid by citing Stuart Sinai, *A Challenge to the Validity of Rule 10b5-1*, 30 Sec. Reg. L.J. 261 (2002). However, in this appeal he does not argue that his instruction was improperly denied, or that Rule 10b5-1 is invalid.

must be held to its *rejected* jury instructions.[12] We do not need to resolve the conundrum here, because the evidence was sufficient to establish both that Mr. Nacchio was aware of the information, and that it was "a factor, however small," in his decision to trade. Because Rule 10b5–1 is unchallenged here, we do not decide whether the evidence is sufficient to demonstrate that Mr. Nacchio actually used inside information, or that it was "a significant factor," as the judge instructed.

2. Sufficiency of the Evidence

The defendant urges that his April and May 2001 sales could not have been "on the basis of" his inside knowledge because he had an entirely innocent explanation: he had to exercise his stock options before they expired in June 2003. But this is not enough to exclude as a matter of law the possibility that inside information was a factor. The fact that his options were expiring means that he had to *exercise* them, but after exercising an option and receiving a share one can either sell that share or hold it. When announcing his intention to start redeeming his stock options in October, Mr. Nacchio said, "I can't just exercise and hold," explaining that because he would be taxed upon

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[12] We have described our rule about the role of uncontested jury instructions in sufficiency-of-the-evidence review both as an application of "the doctrine of law of the case" and as "an equitable remedy whose purpose is to prevent the government from arguing on appeal a position which it abandoned below." *Williams*, 376 F.3d at 1051. On one hand, law of the case normally applies only to issues "[a]ctual[ly] deci[ded]," 18B Charles Alan Wright, Arthur R. Miller, & Edward H. Cooper, *Federal Practice and Procedure* § 4478, at 649 (2d ed.2002), not to arguments that are rejected. On the other, the equitable theory might apply to proffered as well as accepted instructions.

exercising his options, he had to sell them to pay the tax. Aplee.'s Supp.App. exh. 1560. That is a plausible explanation, but the jury did not have to believe it. Mr. Nacchio could have paid the tax out of other assets, or sold only some of the shares, using the proceeds to pay the tax due on the options. Mr. Nacchio also argues that, customarily, CEOs sell stock as soon as they exercise an option. These are powerful arguments for the jury, but they do not establish his innocence as a matter of law.

Mr. Nacchio also argues that his pattern of sales exonerates him and requires us to overturn the jury's verdict. He cancelled his February automatic sales plan in March because Qwest's share price went below $38, and his May plan included a $38 floor. He never sold any more stock after May, and ended the year with more vested options than he owned at the beginning. On its face, this is curious behavior for somebody with inside knowledge that the stock price was likely to plummet. However, the law does not require a defendant to sell most of his stock to be convicted of insider trading. The government argued that Mr. Nacchio stopped selling in May "to avoid detection," Aplee's Br. at 25, and a reasonable jury could have believed this.

In any event, the jury convicted Mr. Nacchio only on trades beginning April 26, acquitting him on trades from January 2 through March 1 (he did not trade between March 1 and April 26), suggesting that the jury acknowledged his legitimate reasons for exercising his options prior to April. By convicting Mr. Nacchio for his April and May trades, it appears the jury was convinced that he sold stock in April and May because he knew at that time that Qwest had not made

the necessary shift to recurring revenue. Mr. Nacchio knew the 2001 budget required Qwest to double its 2000 growth rate for recurring revenue, he knew and agreed that such growth had to happen as early as possible in 2001 to benefit from sufficient compounding, and he knew Qwest's 2001 budget relied on such compounding to generate increased revenue in the third and fourth quarters. Further, as of April 9—after he had abandoned his February trading plan—Mr. Nacchio knew that this needed shift had not occurred, as recurring revenue was off its target by 19%. A reasonable jury could infer from these facts that, notwithstanding Ms. Szeliga's report that the company was on track to make its year-end public target, Mr. Nacchio knew in April that the company's earnings were in jeopardy, and that he acted upon this nonpublic information when deciding to trade in April and May.

IV. RETRIAL

The improper exclusion of Professor Fischel's testimony prejudiced Mr. Nacchio's defense, so we must reverse his conviction. However, because the evidence the government presented was sufficient, the government may try him a second time. Because he will have to be sentenced anew if he is convicted again, we do not need to reach the challenges Mr. Nacchio raises to the forfeiture of his assets or his sentencing enhancement.

Finally, the defendant asks us to assign any new trial to a new district judge. In this Circuit, we exercise our power to do so only where we find either that the judge harbored "personal bias" or on the basis of circumstances laid out in a three-part test:

> (1) whether the original judge would reasonably be expected upon remand to have substantial

> difficulty in putting out of his or her mind previously-expressed views or findings determined to be erroneous or based on evidence that must be rejected, (2) whether reassignment is advisable to preserve the appearance of justice, and (3) whether reassignment would entail waste and duplication out of proportion to any gain in preserving the appearance of fairness.

Mitchell v. Maynard, 80 F.3d 1433, 1448–50 (10th Cir.1996) (quoting *United States v. Sears, Roebuck & Co.*, 785 F.2d 777, 780 (9th Cir.1986)). We do not suggest that the assigned district judge harbored personal bias against Mr. Nacchio, but we do conclude that the factors outlined in *Mitchell* militate in favor of retrial before a different judge. After reading the trial transcript, we have concluded that it would be unreasonably difficult to expect this judge to retry the case with a fresh mind. Because the government will have to retry the case from scratch either way, there is no unnecessary "waste [or] duplication" in reassigning it.

V. CONCLUSION

The judgment of the district court is **REVERSED** and the case is **REMANDED** for a new trial before a different district judge.

HOLMES, Circuit Judge, dissenting in part and concurring in part.

The majority elevates form over substance in concluding that Rule 16 was the foundation for the district court's exclusion of Professor Fischel's expert testimony. *Daubert* was at the heart of the district court's decision, and Mr. Nacchio was on clear notice of this fact. The court did not abuse its discretion in

finding that Mr. Nacchio did not carry his burden under *Daubert* of establishing the admissibility of Professor Fischel's testimony. Accordingly, I respectfully dissent from Section II(A) of the majority's opinion. I concur with the majority's conclusion that Mr. Nacchio failed to establish grounds for reversal in the district court's exclusion of classified information and in its instructions to the jury. I also believe the evidence was legally sufficient to support the jury's verdict. Therefore, I would affirm the district court and uphold Mr. Nacchio's conviction.[1]

The district court's exclusion of Professor Fischel's testimony was about *Daubert*. True, the government first framed its challenge to Professor Fischel's proffered expert testimony as an objection to the sufficiency of Mr. Nacchio's Rule 16 disclosure. However, by the time the district court ruled to exclude Professor Fischel's testimony, it was clear that the court was asking about *Daubert*.

The district court had repeatedly questioned Professor Fischel's methodology—an issue that it must examine under *Daubert*, not Rule 16. Thus, Mr. Nacchio should have known that he had to either make the requested showing or request a *Daubert* hearing.[2]

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[1] In addition to challenging his conviction, Mr. Nacchio raised certain challenges to his sentence. I offer no views regarding the merits of those sentencing challenges.

[2] I agree with the majority that *Daubert* is "legal shorthand for the district court's obligation to test a proposed expert's methodology in advance of his testimony." Maj. Op. at 1149. Logically, it should follow, then, that a district court's repeated probing as to the sufficiency of an expert's methodology, as here, would put an expert witness's proponent on notice that *Daubert* was at issue.

Furthermore, it was incumbent upon Mr. Nacchio, who was offering Professor Fischel as an expert witness, to demonstrate that his proffered expert was qualified to render an expert opinion. Thus, when the district court was asking about methodology, Mr. Nacchio was required to rise to meet his burden of demonstrating that the expert testimony was admissible.

Mr. Nacchio is attempting to take an unexceptional issue and craft it into a tale of an invidious district court ruling. However, it is clear that at best his argument is nothing more than a run-of-the-mill claim of unfair surprise clothed in Rule 16. We have dismissed similar claims when, as here, the record belies them. *See Ralston v. Smith & Nephew Richards, Inc.*, 275 F.3d 965, 970 n. 4 (10th Cir.2001) (rejecting the contention that a party was not informed that her expert's qualifications would be at issue when, *inter alia*, a section of a motion in opposition to the expert raised the issue of the expert's qualifications); *see also Solorio v. United States*, 85 Fed.Appx. 705, 707–10 (10th Cir.2004) (rejecting "essentially a claim of unfair surprise arising from the district court's exclusion of [ ] expert[] testimony" when, *inter alia*, "[t]he government's reply brief mounted an explicit *Daubert* attack" on the expert's reliability).

Mr. Nacchio was on notice that Professor Fischel's qualifications were at issue. As early as the government's first motion regarding Professor Fischel, the government argued that Rule 702 was implicated. Supp.App. at 39. At a March 22, 2007 hearing, both the government and the court raised the concern that there could be issues arising from the *Daubert* line of cases. Mr. Nacchio's counsel responded, "forewarned is forearmed." App. at 2042.

One week following this exchange, Mr. Nacchio provided his revised expert disclosure, and again, the government responded by raising *Daubert* concerns. The government filed a 63–page motion to exclude Professor Fischel's expert testimony based on deficiencies in the Rule 16 disclosure *and* based on Mr. Nacchio's failure to meet his burden to demonstrate that Professor Fischel's testimony was admissible. *See* App. at 363. The government argued that, in addition to Rule 16, there were numerous grounds for excluding Professor Fischel's testimony, including Rules 401, 403, 602, 702, and 703 of the Federal Rules of Evidence.

When Mr. Nacchio responded to this motion the next day, in substance, he addressed *Daubert* issues in discussing Rule 702 and Professor Fischel's qualifications.[3] *See* App. at 463–68. Thus, as of his response on April 4, Mr. Nacchio was not only on notice

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[3] The majority states that Mr. Nacchio made no mention of *Daubert* or Professor Fischel's methodology in this filing. Maj. Op. at 1149–50. Although technically correct that the word "Daubert" is not included, this is one example of how the majority elevates form over substance. Mr. Nacchio's filing contains a section with the heading: "Professor's Opinions Are Proper Under Rule 702." App. at 466. In that section, Mr. Nacchio discusses the "specialized knowledge" that Professor Fischel will purportedly bring to the jury and the analytic approach toward the stock and "other financial data" he has taken to "formulate opinions" (i.e., his methodology). *Id.* Thus, contrary to the majority's assertion, Mr. Nacchio's filing did address *Daubert* and Professor Fischel's methodology. *See Daubert v. Merrell Dow Pharms.*, 509 U.S. 579, 588, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993) ("Here there is a specific Rule that speaks to the contested issue. Rule 702, governing expert testimony, ..."). In short, the substance of this filing underscores Mr. Nacchio's awareness that *Daubert* was in play.

that *Daubert* was in play, but he also had responded to the *Daubert* issues.

The following day (April 5), when Mr. Nacchio called Professor Fischel to the stand, he still had not met his burden of demonstrating that Professor Fischel's testimony was admissible. In particular, Mr. Nacchio had not even mentioned yet the possibility of a *Daubert* hearing. As the party offering the expert, Mr. Nacchio "bore the burden of demonstrating to the district court that [his proffered expert] was qualified to render an expert opinion." *Ralston*, 275 F.3d at 970 n. 4. *See also* Fed.R.Evid. 702 advisory committee's note ("[T]he proponent has the burden of establishing that the pertinent admissibility requirements are met by a preponderance of the evidence.").

The district court made a ruling excluding that testimony *because* Mr. Nacchio had not met his burden of demonstrating admissibility. The Majority's contrary reading of the transcript misses the mark: The district court cannot reasonably be said to have "excluded the evidence on Rule 16 grounds alone." Maj. Op. at 1153. This conclusion is particularly problematic in light of the Supreme Court's recent ruling in *Sprint/United Management Co. v. Mendelsohn*, No. 06-1221, 552 U.S. —, 128 S.Ct. 1140, 170 L.Ed.2d 1 (2008). There, the Court instructed: "An appellate court should not presume that a district court intended an incorrect legal result when the order is equally susceptible of a correct reading, particularly when the applicable standard of review is deferential." *Sprint/United Mgmt. Co.*, 128 S.Ct. at 1146. Here, we have a deferential standard of review, *see id.* at 1145 (noting that there is broad discretion granted to a district court's evidentiary rulings), and a district court

ruling that can be interpreted as coming to a correct legal result.[4] Accordingly, we should not presume that the district court erred in this way.

A fair reading of the district court's ruling indicates that *Daubert* was the driving force behind that

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[4] For example, after stating that Professor Fischel's testimony could be excluded on a number of grounds, the district court said: "Most convincingly, the defendant has made no attempt to comply with Rule 702 or *Daubert* and establish that Fischel's testimony is the product of reliable principles and methods or that Fischel applied some principles and methods reliably in this case." App. at 3915. The district court then stated: "Rule 702 governs this issue." *Id.* This indicates that Rule 702 was the main rationale for the district court's decision.

As support for its interpretation of the record, the majority cites to two parts of the district court's ruling. Maj. Op. at 15. In the first instance, the district court only refers generically to "disclosures" after outlining the contents of the government's motion and indicating it had also read both Mr. Nacchio's Rule 16 disclosure and his reply to the government's motion. App. at 3914. In the second instance, the district court stated that methodology was undisclosed "in *this* expert disclosure." App. at 3917 (emphasis added). However, the district court's previous discussion did not refer to the Rule 16 disclosures. Instead, the district court had just quoted Mr. Nacchio's argument—made in his reply to the government's motion to exclude the testimony—that Professor Fischel's opinions were proper under Rule 702. *Compare* App. at 3916 *with* App. at 466.

At best, the majority has pointed out two ambiguous references to a "disclosure" that arise in the context of the district court's assessment of the sufficiency of Mr. Nacchio's *Daubert* arguments. "When a district court's language is ambiguous, as it was here, it is improper for the court of appeals to presume that the lower court reached an incorrect legal conclusion." *Sprint/United Mgmt. Co.*, at 1145. Although a fair reading of the district court's decision demonstrates that the basis for the ruling was *Daubert*, the Supreme Court's recent guidance further compels the conclusion that it is not proper for us to assume that the district court was basing this ruling on Rule 16.

decision. At that time, Mr. Nacchio had not demonstrated the admissibility of Professor Fischel's testimony. Because Mr. Nacchio bore that burden, he "cannot now complain that []he was unprepared to attend to h[is] burden." *Ralston*, 275 F.3d at 970 n. 4. Yet, this is essentially what Mr. Nacchio's argument boils down to.[5]

On April 9, the date that Professor Fischel—Mr. Nacchio's last witness—finished testifying as a summary witness, Mr. Nacchio requested a *Daubert* hearing *for the first time*. In a footnote of a motion to permit Professor Fischel to provide expert testimony to rebut two government witnesses, Mr. Nacchio asked the court to reconsider its ruling excluding Professor Fischel's expert testimony and noted that "[a]n evidentiary hearing is particularly appropriate" in situations where the court finds a report to be insufficiently detailed. App. at 481 n. 4. Even here, Mr. Nacchio failed to address the key concern that the district court had previously highlighted in excluding

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[5] The majority states that we should not "penalize" a party for failing to present an argument "[w]hen the court does not allow the lawyer" to present it. Maj. Op. at 1154. However, this contention is based on one exchange between Mr. Nacchio's counsel and the district court following the court's ruling to exclude Professor Fischel's testimony and ignores the ample opportunities that Mr. Nacchio previously had to respond. Indeed, it ignores the written response that Mr. Nacchio had already made discussing Rule 702 and Professor Fischel's qualifications. Although Mr. Nacchio may have been on a tight deadline, he never requested a continuance or even a *Daubert* hearing before he called Professor Fischel to the stand. Both of these requests would have been rather simple and certainly would not have required much time at all. Yet, Mr. Nacchio failed to make either request.

Professor Fischel's testimony—his methodology for this particular case.

Neither the government nor the district court was under any obligation to call for a hearing or to prod Mr. Nacchio to supplement his filings. The majority suggests that the district court should have ordered Mr. Nacchio to make a *Daubert* proffer. Maj. Op. at 19, 21. However, we have never required a district court to inquire about *Daubert* issues.[6] Rather, as the proponent of the expert testimony, the admissibility burden of proof rested solely on Mr. Nacchio, and he had a multitude of opportunities to provide more information or even simply to request a hearing. He failed to do any of this. Furthermore, the district court clearly indicated on numerous occasions that it was concerned about Professor Fischel's methodology. Although the court did not specifically order a *Daubert* proffer, through its repeated questions on methodology, it effectively invited Mr. Nacchio to make one. The district court, which has great discretion in deciding what procedures to use in acting as gatekeeper, *see Rodriguez-Felix*, 450 F.3d at 1122, should not now be held to have erred because Mr. Nacchio failed to accept its invitation to alleviate its *Daubert* concerns.

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[6] The majority also states: "The prosecution had every right to demand a *Daubert* hearing to test his methodology." Maj. Op. at 1152. Although it is true that the prosecution could have demanded a hearing, it was likewise under no obligation to do so. In a proffer of expert testimony, the burden is on the party offering the testimony. In this case, that burden was on Mr. Nacchio. Accordingly, when it became apparent that the district court was not convinced that Professor Fischel's testimony was admissible, Mr. Nacchio—not the prosecution—should have requested a *Daubert* hearing.

Mr. Nacchio's attempt to focus this court's attention on Rule 16, which certainly did not require him to demonstrate admissibility, should be unavailing. *Daubert* was the issue, and Mr. Nacchio failed in his *Daubert* obligation to establish the admissibility of Professor Fischel's testimony.

A district court's application of the *Daubert* standard is reviewed for abuse of discretion. *United States v. Rodriguez-Felix*, 450 F.3d 1117, 1122, 1125 (10th Cir.), *cert. denied*, — U.S. —, 127 S.Ct. 420, 166 L.Ed.2d 297 (2006). The party offering the expert "must show that the method employed by the expert ... is scientifically sound and that the opinion is based on facts which satisfy Rule 702's reliability requirements." *Dodge v. Cotter Corp.*, 328 F.3d 1212, 1222 (10th Cir.2003). *See also Ralston*, 275 F.3d at 970 n. 4; Fed.R.Evid. 702 advisory committee's note. The district court has broad discretion in determining how to assess an expert's credibility. *E.g., Rodriguez-Felix*, 450 F.3d at 1122. The exclusion of an expert is not overturned "unless it is arbitrary, capricious, whimsical or manifestly unreasonable or when we are convinced that the district court made a clear error of judgment or exceeded the bounds of permissible choice in the circumstances." *Champagne Metals v. Ken–Mac Metals, Inc.*, 458 F.3d 1073, 1079 (10th Cir.2006) (quoting *United States v. Gabaldon*, 389 F.3d 1090, 1098 (10th Cir.2004)).

Before allowing expert testimony, the district court must satisfy itself that the proffered testimony is both relevant and reliable. *See, e.g., Rodriguez–Felix*, 450 F.3d at 1122; *United States v. Fredette*, 315 F.3d 1235, 1239 (10th Cir.2003). "The touchstone for relevance, in this context, is whether 'the evidence or testimony

[will] assist the trier of fact to understand the evidence or to determine a fact in issue.'" *Gabaldon*, 389 F.3d at 1098 (quoting *Daubert*, 509 U.S. at 591, 113 S.Ct. 2786). In making a reliability determination, "[g]enerally, the district court should focus on an expert's methodology rather than the conclusions it generates." *Dodge*, 328 F.3d at 1222.

As to relevance, the district court stated that much of Professor Fischel's testimony was nothing but argument based on factual matters before the court, a summary of stock sales and prices, and issues within the common knowledge of the jury. Such reasons for excluding expert testimony are perfectly reasonable and, indeed, have been upheld by this court. *See Gabaldon*, 389 F.3d at 1099 (upholding the exclusion of expert testimony when it was "not something for which expert testimony is needed"); *Fredette*, 315 F.3d at 1240 (upholding the exclusion of expert testimony when it "did not deal with matters outside the everyday knowledge of a typical juror"). Furthermore, the district court noted that some evidence was completely irrelevant. For example, Professor Fischel was set to testify regarding what Michael Eisner and Michael Dell were doing with stock in their companies when Mr. Nacchio was selling his stock. In sum, the district court's conclusions are not so unreasonable that they exceeded permissible choice. It was certainly permissible for the district court to conclude that this evidence was not relevant.

The district court could have excluded Professor Fischel's testimony on grounds of relevance alone, but the court also noted concerns regarding Professor Fischel's methodology. The majority "conclude[s] that at a minimum it is an abuse of discretion to exclude an

expert witness because his methodology is unreliable without allowing the proponent to present *any* evidence of what the methodology would be." Maj. Op. at 23-24. However, the record clearly establishes that Mr. Nacchio proffered information concerning Professor Fischel's methodology.[7] Indeed, Mr. Nacchio's counsel admitted as much. Oral Arg. at 47:19-47:48 (responding to a question about what methodology had been provided, Mr. Nacchio's attorney indicated: "He described in detail—at least

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[7] Without any legal support, the majority suggests that a district court cannot make a Daubert ruling without hearing testimony or receiving submissions. Maj. Op. at 1153-54. However, we have never required a district court to *sua sponte* request either a hearing or more submissions and certainly no obligation of that sort would appear to exist in the *Daubert* context. Indeed, we have repeatedly held that "[t]he district court retains broad discretion in deciding how to assess an expert's reliability, *including what procedures to utilize in making that assessment*, as well as in making the ultimate determination of reliability." *Rodriguez-Felix*, 450 F.3d at 1122 (emphasis added) (citing *Dodge*, 328 F.3d at 1223). Contrary to the majority's contention, there was information before the district court on the question for decision—whether Professor Fischel's proffered expert testimony satisfied *Daubert*. Mr. Nacchio had submitted filings regarding Rule 702 and at least ten pages of methodology that the district court did review before excluding Professor Fischel's testimony. Furthermore, we place the burden on the party offering the expert testimony to demonstrate admissibility. *Ralston*, 275 F.3d at 970 n. 4. *See also* Fed.R.Evid. 702 advisory committee's note. Accordingly, it was incumbent upon Mr. Nacchio to make the appropriate submissions, through a requested *Daubert* hearing or otherwise—particularly given that the district court had been drawing his attention to its concern over methodology. In other words, insofar as there were any gaps in the record before the district court when it made its *Daubert* ruling, Mr. Nacchio must be held responsible for them and should bear the adverse consequences of not filling them.

ten pages of detail.... There's ten pages that's nothing but that."). Accordingly, by Mr. Nacchio's own admission, the district court had information about methodology in front of it when ruling on the issue.

In the "ten pages" of methodology offered by Mr. Nacchio, it is indicated that Professor Fischel was basing his opinion on his analysis of, *inter alia*, market and stock-related information. This indicates that Professor Fischel was applying his experience to material that he reviewed to formulate an opinion. A witness's testimony can rely solely on experience. However, when that is the case, "the witness must explain how that experience leads to the conclusion reached, why that experience is a sufficient basis for the opinion, and how that experience is reliably applied to the facts." Fed.R.Evid. 702 advisory committee's note. Mr. Nacchio did not offer any of that additional information. "The trial court's gatekeeping function requires more than simply taking the expert's word for it." *Id.* (internal quotation marks and citation omitted). "[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert." *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146, 118 S.Ct. 512, 139 L.Ed.2d 508 (1997).

Mr. Nacchio seems to rely on Professor Fischel's qualifications to tip the balance in favor of the admissibility of his testimony. In doing so, he ignores that when assessing expert testimony, "the question before the trial court [i]s specific, not general." *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 156, 119 S.Ct. 1167, 143 L.Ed.2d 238 (1999). Although Professor Fischel generally has been allowed to testify in the past and a district court might well respect his credentials,

it has an obligation to assess the methodology that Professor Fischel has employed in the case at hand and whether he has specialized knowledge that can assist the jurors in that case. *See id.* at 153–56, 119 S.Ct. 1167; *Rodriguez-Felix*, 450 F.3d at 1122; *Fredette*, 315 F.3d at 1239–40. Mr. Nacchio could not just assume that his expert would be admitted because his testimony was allowed in other cases; he had to meet his burden of demonstrating admissibility in this particular case. As the district court noted, Mr. Nacchio "made no attempt" to do this. App. at 3915.

Mr. Nacchio failed to satisfy the district court that Professor Fischel's testimony would be either reliable or relevant. The district court was well within its discretion in excluding Professor Fischel's expert testimony. *See Rodriguez–Felix*, 450 F.3d at 1125 (finding no abuse of discretion when the district court excluded testimony based on the "woefully inadequate" report regarding proffered testimony).

Of course, I would find it troubling if a district court unilaterally used a ruling regarding the propriety of a Rule 16 disclosure to effectively exclude an expert witness on *Daubert* grounds—without any notice to the party offering the expert. But that is not what happened here. Mr. Nacchio had ample notice that the methodology underlying Professor Fischel's opinion (i.e., a *Daubert* question) was at issue and bore the burden of demonstrating that the testimony was admissible. He easily could have requested a hearing or fully addressed the issue in briefing. Mr. Nacchio failed to do so. Consequently, there is no foundation to his claim for a new trial.

I respectfully dissent and would affirm Mr. Nacchio's conviction.

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

UNITED STATES of America, Plaintiff-Appellee,

v.

Joseph P. NACCHIO, Defendant-Appellant.

No. 07-1311.

July 30, 2008

535 F.3d 1165

Before HENRY, Chief Judge, TACHA, KELLY, BRISCOE, LUCERO, MURPHY, HARTZ, McCONNELL, and HOLMES, Circuit Judges.*

ORDER

The petition for rehearing en banc is GRANTED. This case is set for oral argument on Thursday, September 25, 2008, at 1:00 P.M. in Denver, Colorado.

Within 30 days from the date of this order, the parties shall contemporaneously file supplemental briefs, not to exceed 60 pages in length, addressing the following questions:

1. Was the defendant sufficiently on notice that he was required either to present evidence in support of the expert's methodology or

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* Circuit Judges O'Brien, Tymkovich, and Gorsuch are not participating.

request an evidentiary hearing in advance of presenting the expert's testimony?

2. Did the defendant have an adequate opportunity to present such evidence or request an evidentiary hearing in advance of presenting the expert's testimony?
3. Did the defendant bear the burden of requesting an evidentiary hearing?
4. Did the district court abuse its discretion in disallowing the evidence, and if so, is the appropriate remedy necessarily a new trial, or is a remand for purposes of conducting an evidentiary hearing adequate?

Parties shall file 15 copies of the supplemental briefs. At the time the parties file their supplemental en banc briefs, they shall also file an additional 15 copies of their original panel briefs on the merits.

Within 15 days after service of the initial supplemental briefs, the parties may contemporaneously file supplemental reply briefs. The supplemental reply briefs shall not exceed 30 pages in length. Parties shall file 15 copies of the supplemental reply briefs. All en banc briefs shall comply with the requirements of Fed. R.App. P. 32(a)(7).

CONSTITUTION OF THE UNITED STATES

Amendment V

Section 1. . . . No person shall be . . . deprived of life, liberty, or property, without due process . . . .

* * *

TITLE 15. COMMERCE AND TRADE
CHAPTER 2B. SECURITIES EXCHANGES

15 U.S.C. § 78j

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * *

TITLE 15. COMMERCE AND TRADE
CHAPTER 2B. SECURITIES EXCHANGES

15 U.S.C. § 78ff

§ 78ff. Penalties

(a) Willful violations; false and misleading statements

Any person who willfully violates any provision of this title (other than section 78dd-1 of this title), or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $25,000,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

(b) Failure to file information, documents, or reports

Any issuer which fails to file information, documents, or reports required to be filed under subsection (d) of section 78*o* of this title or any rule or regulation thereunder shall forfeit to the United States the sum of $100 for each and every day such failure to file shall continue. Such forfeiture, which shall be in lieu of any criminal penalty for such failure to file which might be deemed to arise under subsection (a) of this section, shall be payable to the Treasury of the United States and shall be recoverable in a civil suit in the name of the United States.

(c) Violations by issuers, officers, directors, stockholders, employees, or agents of issuers

(1)(A) Any issuer that violates subsection (a) or (g) of section 78dd-1 of this title shall be fined not more than $ 2,000,000.

(B) Any issuer that violates subsection (a) or (g) of section 78dd-1 of this title shall be subject to a civil penalty of not more than $10,000 imposed in an action brought by the Commission.

(2)(A) Any officer, director, employee, or agent of an issuer, or stockholder acting on behalf of such issuer, who willfully violates subsection (a) or (g) of section 78dd-1 of this title shall be fined not more than $100,000, or imprisoned not more than 5 years, or both.

(B) Any officer, director, employee, or agent of an issuer, or stockholder acting on behalf of such issuer, who violates subsection (a) or (g) of section 78dd-1 of this title shall be subject to a civil penalty of not more than $10,000 imposed in an action brought by the Commission.

(3) Whenever a fine is imposed under paragraph (2) upon any officer, director, employee, agent, or stockholder of an issuer, such fine may not be paid, directly or indirectly, by such issuer.

TITLE 17 -- COMMODITY AND SECURITIES EXCHANGES
CHAPTER II -- SECURITIES AND EXCHANGE COMMISSION
PART 230 -- GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933
GENERAL

17 C.F.R. § 230.175

§ 230.175 Liability for certain statements by issuers.

(a) A statement within the coverage of paragraph (b) of this section which is made by or on behalf of an issuer or by an outside reviewer retained by the issuer shall be deemed not to be a fraudulent statement (as defined in paragraph (d) of this section), unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

* * *

TITLE 17 -- COMMODITY AND SECURITIES EXCHANGES
CHAPTER II -- SECURITIES AND EXCHANGE COMMISSION
PART 240 -- GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934
SUBPART A -- RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934
DEFINITIONS

17 CFR 240.3b-6

§ 240.3b-6 Liability for certain statements by issuers.

(a) A statement within the coverage of paragraph (b) of this section which is made by or on behalf of an issuer or by an outside reviewer retained by the issuer shall be deemed not to be a fraudulent statement (as defined in paragraph (d) of this section), unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

* * *

64 Federal Register 45,150 (Aug. 19, 1999)

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 211

[Release No. SAB 99]

Staff Accounting Bulletin No. 99

AGENCY: Securities and Exchange Commission.

ACTION: Publication of Staff Accounting Bulletin.

SUMMARY: This staff accounting bulletin expresses the views of the staff that exclusive reliance on certain quantitative benchmarks to assess materiality in preparing financial statements and performing audits of those financial statements is inappropriate; misstatements are not immaterial simply because they fall beneath a numerical threshold.

DATES: Effective August 12, 1999.

FOR FURTHER INFORMATION CONTACT: W. Scott Bayless, Associate Chief Accountant, or Robert E. Burns, Chief Counsel, Office of the Chief Accountant (202-942-4400), or David R. Fredrickson, Office of General Counsel (202-942-0900), Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-1103; electronic addresses: BaylessWS@sec.gov; BurnsR@sec.gov; FredricksonD @sec.gov.

SUPPLEMENTARY INFORMATION: The statements in the staff accounting bulletins are not rules or interpretations of the Commission, nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the Federal securities laws.

Dated: August 12, 1999.

Margaret H. McFarland,

Deputy Secretary.

PART 211--[AMENDED]

Accordingly, Part 211 of Title 17 of the Code of Federal Regulations is amended by adding Staff Accounting Bulletin No. 99 to the table found in Subpart B.

Staff Accounting Bulletin No. 99

The staff hereby adds Section M to Topic 1 of the Staff Accounting Bulletin Series. Section M, entitled "Materiality," provides guidance in applying materiality thresholds to the preparation of financial statements filed with the Commission and the performance of audits of those financial statements.

Staff Accounting Bulletins

Topic 1: Financial Statements

* * * * *

[41151]

M. Materiality

1. Assessing Materiality

Facts: During the course of preparing or auditing year-end financial statements, financial management or the registrant's independent auditor becomes aware of misstatements in a registrant's financial statements. When combined, the misstatements result in a 4% overstatement of net income and a $.02 (4%) overstatement of earnings per share. Because no item in the registrant's consolidated financial statements is misstated by more than 5%, management and the independent auditor conclude that the deviation from generally accepted accounting principles ("GAAP") is immaterial and that the accounting is permissible.[1]

Question: Each Statement of Financial Accounting Standards adopted by the Financial Accounting Standards Board ("FASB") states, "The provisions of this Statement need not be applied to immaterial items." In the staff's view, may a registrant or the

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[1] American Institute of Certified Public Accountants ("AICPA"), Codification of Statements on Auditing Standards ("AU") §312, "Audit Risk and Materiality in Conducting an Audit," states that the auditor should consider audit risk and materiality both in (a) planning and setting the scope for the audit and (b) evaluating whether the financial statements taken as a whole are fairly presented in all material respects in conformity with generally accepted accounting principles. The purpose of this Staff Accounting Bulletin ("SAB") is to provide guidance to financial management and independent auditors with respect to the evaluation of the materiality of misstatements that are identified in the audit process or preparation of the financial statements (*i.e.*, (b) above). This SAB is not intended to provide definitive guidance for assessing "materiality" in other contexts, such as evaluations of auditor independence, as other factors may apply. There may be other rules that address financial presentation. *See, e.g.*, Rule 2a-4, 17 CFR 270.2a-4, under the Investment Company Act of 1940.

auditor of its financial statements assume the immateriality of items that fall below a percentage threshold set by management or the auditor to determine whether amounts and items are material to the financial statements?

Interpretive Response: No. The staff is aware that certain registrants, over time, have developed quantitative thresholds as "rules of thumb" to assist in the preparation of their financial statements, and that auditors also have used these thresholds in their evaluation of whether items might be considered material to users of a registrant's financial statements. One rule of thumb in particular suggests that the misstatement or omission[2] of an item that falls under a 5% threshold is not material in the absence of particularly egregious circumstances, such as self-dealing or misappropriation by senior management. The staff reminds registrants and the auditors of their financial statements that exclusive reliance on this or any percentage or numerical threshold has no basis in the accounting literature or the law.

The use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that—without considering all relevant circumstances—a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material. The staff has no objection to such a "rule of thumb" as an initial step in assessing materiality. But quantifying, in percentage terms, the magnitude of a

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[2] As used in this SAB, "misstatement" or "omission" refers to a financial statement assertion that would not be in conformity with GAAP.

misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations.

Materiality concerns the significance of an item to users of a registrant's financial statements. A matter is "material" if there is a substantial likelihood that a reasonable person would consider it important. In its Statement of Financial Accounting Concepts No. 2, the FASB stated the essence of the concept of materiality as follows:

> The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.[3]

This formulation in the accounting literature is in substance identical to the formulation used by the courts in interpreting the federal securities laws. The Supreme Court has held that a fact is material if there is—

> a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.[4]

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[3] FASB, Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information* ("Concepts Statement No. 2"), ¶132 (1980). *See also* Concepts Statement No. 2, Glossary of Terms—Materiality.

[4] *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976). *See also Basic, Inc. v. Levinson*, 485 U.S. 224 (1988). As the

Under the governing principles, an assessment of materiality requires that one views the facts in the context of the "surrounding circumstances," as the accounting literature puts it, or the "total mix" of information, in the words of the Supreme Court. In the context of a misstatement of a financial statement item, while the "total mix" includes the size in numerical or percentage terms of the misstatement, it also includes the factual context in which the user of financial statements would view the financial statement item. The shorthand in the accounting and auditing literature for this analysis is that financial management and the auditor must consider both "quantitative" and "qualitative" factors in assessing an item's materiality.[5] Court decisions, Commission rules and enforcement actions, and accounting and auditing literature[6] have all considered "qualitative" factors in various contexts.

Supreme Court has noted, determinations of materiality require "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him. . . . ." *TSC Industries*, 426 U.S. at 450.

[5] *See, e.g.*, Concepts Statement No. 2, ¶¶123-124; AU §312.10 ("... materiality judgments are made in light of surrounding circumstances and necessarily involve both quantitative and qualitative considerations."); AU §312.34 ("Qualitative considerations also influence the auditor in reaching a conclusion as to whether misstatements are material."). As used in the accounting literature and in this SAB, "qualitative" materiality refers to the surrounding circumstances that inform an investor's evaluation of financial statement entries. Whether events may be material to investors for non-financial reasons is a matter not addressed by this SAB.

[6] *See, e.g.*, Rule 1-02(o) of Regulation S-X, 17 CFR 210.1-02(o), Rule 405 of Regulation C, 17 CFR 230.405, and Rule 12b-2, 17 CFR 240.12b-2; AU §§312.10–.11, 317.13, 411.04 n. 1, and 508.36; *In re Kidder Peabody Securities Litigation*, 10 F. Supp. 2d 398

The FASB has long emphasized that materiality cannot be reduced to a numerical formula. In its Concepts Statement No. 2, the FASB noted that some had urged it to promulgate quantitative materiality guides for use in a variety of situations. The FASB rejected such an approach as representing only a "minority view," stating—

> The predominant view is that materiality judgments can properly be made only by those who have all the facts. The Board's present position is that no general standards of materiality could be formulated to take into account all the considerations that enter into an experienced human judgment.[7]

The FASB noted that, in certain limited circumstances, the Commission and other authoritative bodies had issued quantitative materiality guidance, citing as examples guidelines ranging from one to ten percent with **[45152]** respect to a variety of disclosures.[8] And it took account of contradictory studies, one showing a lack of uniformity among auditors on materiality judgments, and another suggesting widespread use of a "rule of thumb" of five

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(S.D.N.Y. 1998); *Parnes v. Gateway 2000, Inc.*, 122 F.3d 539 (8th Cir. 1997); *In re Westinghouse Securities Litigation*, 90 F.3d 696 (3d Cir. 1996); *In the Matter of W.R. Grace & Co.*, Accounting and Auditing Enforcement Release No. ("AAER") 1140 (June 30, 1999); *In the Matter of Eugene Gaughan*, AAER 1141 (June 30, 1999); *In the Matter of Thomas Scanlon*, AAER 1142 (June 30, 1999); and *In re Sensormatic Electronics Corporation*, Sec. Act Rel. No. 7518 (March 25, 1998).

[7] Concepts Statement No. 2, ¶131 (1980).

[8] Concepts Statement No. 2, ¶¶131 and 166.

to ten percent of net income.[9] The FASB also considered whether an evaluation of materiality could be based solely on anticipating the market's reaction to accounting information.[10]

The FASB rejected a formulaic approach to discharging "the onerous duty of making materiality decisions"[11] in favor of an approach that takes into account all the relevant considerations. In so doing, it made clear that—

> [M]agnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment.[12]

Evaluation of materiality requires a registrant and its auditor to consider *all* the relevant circumstances, and the staff believes that there are numerous circumstances in which misstatements below 5% could well be material. Qualitative factors may cause misstatements of quantitatively small amounts to be material; as stated in the auditing literature:

> As a result of the interaction of quantitative and qualitative considerations in materiality judgments, misstatements of relatively small amounts that come to the auditor's attention could have a material effect on the financial statements.[13]

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[9] Concepts Statement No. 2, ¶167.

[10] Concepts Statement No. 2, ¶¶168-69.

[11] Concepts Statement No. 2, ¶170.

[12] Concepts Statement No. 2, ¶¶125.

[13] AU §312.11.

Among the considerations that may well render material a quantitatively small misstatement of a financial statement item are—

- Whether the misstatement arises from an item capable of precise measurement or whether it arises from an estimate and, if so, the degree of imprecision inherent in the estimate[14]
- Whether the misstatement masks a change in earnings or other trends.
- Whether the misstatement hides a failure to meet analysts' consensus expectations for the enterprise.
- Whether the misstatement changes a loss into income or vice versa.
- Whether the misstatement concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability.

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[14] As stated in Concepts Statement No. 2, ¶¶130:

> Another factor in materiality judgments is the degree of precision that is attainable in estimating the judgment item. The amount of deviation that is considered immaterial may increase as the attainable degree of precision decreases. For example, accounts payable usually can be estimated more accurately than can contingent liabilities arising from litigation or threats of it, and a deviation considered to be material in the first case may be quite trivial in the second.

This SAB is not intended to change current law or guidance in the accounting literature regarding accounting estimates. *See, e.g.*, Accounting Principles Board Opinion No. 20, *Accounting Changes* ¶¶10, 11, 31-33 (July 1971).

- Whether the misstatement affects the registrant's compliance with regulatory requirements.
- Whether the misstatement affects the registrant's compliance with loan covenants or other contractual requirements.
- Whether the misstatement has the effect of increasing management's compensation—for example, by satisfying requirements for the award of bonuses or other forms of incentive compensation.
- Whether the misstatement involves concealment of an unlawful transaction.

This is not an exhaustive list of the circumstances that may affect the materiality of a quantitatively small misstatement.[15] Among other factors, the demonstrated volatility of the price of a registrant's securities in response to certain types of disclosures may provide guidance as to whether investors regard quantitatively small misstatements as material. Consideration of potential market reaction to disclosure of a misstatement is by itself "too blunt an instrument to be depended on" in considering whether a fact is material.[16] When, however, management or

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[15] The staff understands that the Big Five Audit Materiality Task Force ("Task Force") was convened in March of 1998 and has made recommendations to the Auditing Standards Board including suggestions regarding communications with audit committees about unadjusted misstatements. *See generally* Big Five Audit Materiality Task Force, "Materiality in a Financial Statement Audit –Considering Qualitative Factors When Evaluating Audit Findings" (August 1998). The Task Force memorandum is available at www.aicpa.org.

[16] *See* Concepts Statement No. 2, ¶169.

the independent auditor expects (based, for example, on a pattern of market performance) that a known misstatement may result in a significant positive or negative market reaction, that expected reaction should be taken into account when considering whether a misstatement is material.[17]

For the reasons noted above, the staff believes that a registrant and the auditors of its financial statements should not assume that even small intentional misstatements in financial statements, for example those pursuant to actions to "manage" earnings, are immaterial.[18] While the intent of management does not render a misstatement material, it may provide significant evidence of materiality. The evidence may be particularly compelling where management has intentionally misstated items in the financial statements to "manage" reported earnings. In that instance, it presumably has done so believing that the resulting amounts and trends would be significant to users of the registrant's financial statements.[19] The staff believes that investors generally would regard as significant a management practice to over- or under-

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[17] If management does not expect a significant market reaction, a misstatement still may be material and should be evaluated under the criteria discussed in this SAB.

[18] Intentional management of earnings and intentional misstatements, as used in this SAB, do not include insignificant errors and omissions that may occur in systems and recurring processes in the normal course of business. *See* notes 38 and 50 *infra*.

[19] Assessments of materiality should occur not only at year-end, but also during the preparation of each quarterly or interim financial statement. *See, e.g., In the Matter of Venator Group, Inc.*, AAER 1049 (June 29, 1998).

state earnings up to an amount just short of a percentage threshold in order to "manage" earnings. Investors presumably also would regard as significant an accounting practice that, in essence, rendered all earnings figures subject to a management-directed margin of misstatement.

The materiality of a misstatement may turn on where it appears in the financial statements. For example, a misstatement may involve a segment of the registrant's operations. In that instance, in assessing materiality of a misstatement to the financial statements taken as a whole, registrants and their auditors should consider not only the size of the misstatement but also the significance of the segment information to the financial statements taken as a whole.[20] "A misstatement of the revenue and operating profit of a relatively small segment that is represented by management to be important to the future profitability of the entity"[21] is more likely to be material to investors than a misstatement in a segment that management has not identified as especially important. In assessing the materiality of misstatements in segment information—as with materiality generally—

> situations may arise in practice where the auditor will conclude that a matter relating to segment information is qualitatively material even though, in his or her judgment, it is

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[20] *See, e.g., In the Matter of W.R. Grace & Co.*, AAER 1140 (June 30, 1999).

[21] AUI §326.33.

> quantitatively immaterial to the financial statements taken as a whole.[22]

[45153]

Aggregating and Netting Misstatements

In determining whether multiple misstatements cause the financial statements to be materially misstated, registrants and the auditors of their financial statements should consider each misstatement separately and the aggregate effect of all misstatements.[23] A registrant and its auditor should evaluate misstatements in light of quantitative and qualitative factors and "consider whether, in relation to individual line item amounts, subtotals, or totals in the financial statements, they materially misstate the financial statements taken as a whole."[24] This requires consideration of—

> the significance of an item to a particular entity (for example, inventories to a

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[22] *Id.*

[23] The auditing literature notes that the "concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles." AU §312.03. *See also* AU §312.04.

[24] AU §312.34. Quantitative materiality assessments often are made by comparing adjustments to revenues, gross profit, pretax and net income, total assets, stockholders' equity, or individual line items in the financial statements. The particular items in the financial statements to be considered as a basis for the materiality determination depend on the proposed adjustment to be made and other factors, such as those identified in this SAB. For example, an adjustment to inventory that is immaterial to pretax income or net income may be material to the financial statements because it may affect a working capital ratio or cause the registrant to be in default of loan covenants.

> manufacturing company), the pervasiveness of the misstatement (such as whether it affects the presentation of numerous financial statement items), and the effect of the misstatement on the financial statements taken as a whole. . . .[25]

Registrants and their auditors first should consider whether each misstatement is material, irrespective of its effect when combined with other misstatements. The literature notes that the analysis should consider whether the misstatement of "individual amounts" causes a material misstatement of the financial statements taken as a whole. As with materiality generally, this analysis requires consideration of both quantitative and qualitative factors.

If the misstatement of an individual amount causes the financial statements as a whole to be materially misstated, that effect cannot be eliminated by other misstatements whose effect may be to diminish the impact of the misstatement on other financial statement items. To take an obvious example, if a registrant's revenues are a material financial statement item and if they are materially overstated, the financial statements taken as a whole will be materially misleading even if the effect on earnings is completely offset by an equivalent overstatement of expenses.

Even though a misstatement of an individual amount may not cause the financial statements taken as a whole to be materially misstated, it may nonetheless, when aggregated with other misstatements, render the financial statements taken as a whole to be materially misleading. Registrants

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[25] AU §508.36.

and the auditors of their financial statements accordingly should consider the effect of the misstatement on subtotals or totals. The auditor should aggregate all misstatements that affect each subtotal or total and consider whether the misstatements in the aggregate affect the subtotal or total in a way that causes the registrant's financial statements taken as a whole to be materially misleading.[26]

The staff believes that, in considering the aggregate effect of multiple misstatements on a subtotal or total, registrants and the auditors of their financial statements should exercise particular care when considering whether to offset (or the appropriateness of offsetting) a misstatement of an estimated amount with a misstatement of an item capable of precise measurement. As noted above, assessments of materiality should never be purely mechanical; given the imprecision inherent in estimates, there is by definition a corresponding imprecision in the aggregation of misstatements involving estimates with those that do not involve an estimate.

Registrants and auditors also should consider the effect of misstatements from prior periods on the current financial statements. For example, the auditing literature states,

> Matters underlying adjustments proposed by the auditor but not recorded by the entity could potentially cause future financial statements to be materially misstated, even though the auditor has

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[26] AU §312.34.

concluded that the adjustments are not material to the current financial statements.[27]

This may be particularly the case where immaterial misstatements recur in several years and the cumulative effect becomes material in the current year.

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[27] AU §380.09.

Federal Rule of Criminal Procedure 16

Rule 16. Discovery and Inspection

(a) Government's Disclosure.

(1) ***Information Subject to Disclosure.***

(A) *Defendant's Oral Statement.*

Upon a defendant's request, the government must disclose to the defendant the substance of any relevant oral statement made by the defendant, before or after arrest, in response to interrogation by a person the defendant knew was a government agent if the government intends to use the statement at trial.

(B) *Defendant's Written or Recorded Statement.*

Upon a defendant's request, the government must disclose to the defendant, and make available for inspection, copying, or photographing, all of the following:

(i) any relevant written or recorded statement by the defendant if:

- the statement is within the government's possession, custody, or control; and
- the attorney for the government knows—or through due diligence could know—that the statement exists;

(ii) the portion of any written record containing the substance of any relevant oral statement made before or after arrest if the defendant made the statement in response to interrogation by a person the defendant knew was a government agent; and

(iii) the defendant's recorded testimony before a grand jury relating to the charged offense.

(C) *Organizational Defendant.*

Upon a defendant's request, if the defendant is an organization, the government must disclose to the defendant any statement described in Rule 16(a)(1)(A) and (B) if the government contends that the person making the statement:

(i) was legally able to bind the defendant regarding the subject of the statement because of that person's position as the defendant's director, officer, employee, or agent; or

(ii) was personally involved in the alleged conduct constituting the offense and was legally able to bind the defendant regarding that conduct because of that person's position as the defendant's director, officer, employee, or agent.

(D) *Defendant's Prior Record.*

Upon a defendant's request, the government must furnish the defendant with a copy of the defendant's prior criminal record that is within the government's possession, custody, or control if the attorney for the government knows—or through due diligence could know—that the record exists.

(E) *Documents and Objects.*

Upon a defendant's request, the government must permit the defendant to inspect and to copy or photograph books, papers, documents, data, photographs, tangible objects, buildings or places, or copies or portions of any of these items, if the item is

within the government's possession, custody, or control and:

(i) the item is material to preparing the defense;

(ii) the government intends to use the item in its case-in-chief at trial; or

(iii) the item was obtained from or belongs to the defendant.

(F) *Reports of Examinations and Tests.*

Upon a defendant's request, the government must permit a defendant to inspect and to copy or photograph the results or reports of any physical or mental examination and of any scientific test or experiment if:

(i) the item is within the government's possession, custody, or control;

(ii) the attorney for the government knows—or through due diligence could know—that the item exists; and

(iii) the item is material to preparing the defense or the government intends to use the item in its case-in-chief at trial.

(G) *Expert Witnesses.*

At the defendant's request, the government must give to the defendant a written summary of any testimony that the government intends to use under Rules 702, 703, or 705 of the Federal Rules of Evidence during its case-in-chief at trial. If the government requests discovery under subdivision (b)(1)(C)(ii) and the defendant complies, the government must, at the defendant's request, give to the defendant a written

summary of testimony that the government intends to use under Rules 702, 703, or 705 of the Federal Rules of Evidence as evidence at trial on the issue of the defendant's mental condition. The summary provided under this subparagraph must describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications.

(2) ***Information Not Subject to Disclosure.***

Except as Rule 16(a)(1) provides otherwise, this rule does not authorize the discovery or inspection of reports, memoranda, or other internal government documents made by an attorney for the government or other government agent in connection with investigating or prosecuting the case. Nor does this rule authorize the discovery or inspection of statements made by prospective government witnesses except as provided in 18 U.S.C. §3500.

(3) ***Grand Jury Transcripts.***

This rule does not apply to the discovery or inspection of a grand jury's recorded proceedings, except as provided in Rules 6, 12(h), 16(a)(1), and 26.2.

(b) Defendant's Disclosure.

(1) ***Information Subject to Disclosure.***

(A) *Documents and Objects.*

If a defendant requests disclosure under Rule 16(a)(1)(E) and the government complies, then the defendant must permit the government, upon request, to inspect and to copy or photograph books, papers, documents, data, photographs, tangible objects, buildings or places, or copies or portions of any of these items if:

(i) the item is within the defendant's possession, custody, or control; and

(ii) the defendant intends to use the item in the defendant's case-in-chief at trial.

(B) *Reports of Examinations and Tests.*

If a defendant requests disclosure under Rule 16(a)(1)(F) and the government complies, the defendant must permit the government, upon request, to inspect and to copy or photograph the results or reports of any physical or mental examination and of any scientific test or experiment if:

(i) the item is within the defendant's possession, custody, or control; and

(ii) the defendant intends to use the item in the defendant's case-in-chief at trial, or intends to call the witness who prepared the report and the report relates to the witness's testimony.

(C) *Expert Witnesses.*

The defendant must, at the government's request, give to the government a written summary of any testimony that the defendant intends to use under Rules 702, 703, or 705 of the Federal Rules of Evidence as evidence at trial, if—

(i) the defendant requests disclosure under subdivision (a)(1)(G) and the government complies; or

(ii) the defendant has given notice under Rule 12.2(b) of an intent to present expert testimony on the defendant's mental condition.

This summary must describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications[.]

(2) *Information Not Subject to Disclosure.*

Except for scientific or medical reports, Rule 16(b)(1) does not authorize discovery or inspection of:

(A) reports, memoranda, or other documents made by the defendant, or the defendant's attorney or agent, during the case's investigation or defense; or

(B) a statement made to the defendant, or the defendant's attorney or agent, by:

(i) the defendant;

(ii) a government or defense witness; or

(iii) a prospective government or defense witness.

(c) Continuing Duty to Disclose.

A party who discovers additional evidence or material before or during trial must promptly disclose its existence to the other party or the court if:

(1) the evidence or material is subject to discovery or inspection under this rule; and

(2) the other party previously requested, or the court ordered, its production.

(d) Regulating Discovery.

(1) *Protective and Modifying Orders.*

At any time the court may, for good cause, deny, restrict, or defer discovery or inspection, or grant other appropriate relief. The court may permit a party to show good cause by a written statement that the court will inspect ex parte. If relief is granted, the

court must preserve the entire text of the party's statement under seal.

(2) *Failure to Comply.*

If a party fails to comply with this rule, the court may:

(A) order that party to permit the discovery or inspection; specify its time, place, and manner; and prescribe other just terms and conditions;

(B) grant a continuance;

(C) prohibit that party from introducing the undisclosed evidence; or

(D) enter any other order that is just under the circumstances.

Federal Rule of Evidence 104

Rule 104. Preliminary Questions

(a) **Questions of admissibility generally.** Preliminary questions concerning the qualification of a person to be a witness, the existence of a privilege, or the admissibility of evidence shall be determined by the court, subject to the provisions of subdivision (b). In making its determination it is not bound by the rules of evidence except those with respect to privileges.

(b) **Relevancy conditioned on fact.** When the relevancy of evidence depends upon the fulfillment of a condition of fact, the court shall admit it upon, or subject to, the introduction of evidence sufficient to support a finding of the fulfillment of the condition.

(c) **Hearing of jury.** Hearings on the admissibility of confessions shall in all cases be conducted out of the hearing of the jury. Hearings on other preliminary matters shall be so conducted when the interests of justice require, or when an accused is a witness and so requests.

(d) **Testimony by accused.** The accused does not, by testifying upon a preliminary matter, become subject to cross-examination as to other issues in the case.

(e) **Weight and credibility.** This rule does not limit the right of a party to introduce before the jury evidence relevant to weight or credibility.

Federal Rule of Evidence 702

Rule 702. Testimony by Experts

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

INDICTMENT
15 U.S.C. § 78j
15 U.S.C. § 78ff
17 C.F.R. § 240.10b-5
17 C.F.R. § 240.10b5-1
18 U.S.C. § 981
28 U.S.C. § 2461

COUNTS ONE THROUGH FORTY TWO
(Securities Fraud - Insider Trading)

The Grand Jury charges that at all times relevant to this Indictment:

1. Defendant JOSEPH P. NACCHIO ("NACCHIO") was employed as the Chief Executive Officer and a member of the Board of Directors of Qwest Communications International Inc. ("Qwest") and its predecessors from in or about January 1997 until June 2002.
2. Qwest was a publicly held company whose shares traded on the New York Stock Exchange under the ticker symbol "Q".

3. Qwest, through NACCHIO and others, reported its financial results, including its revenues, earnings and growth rates, to the public each fiscal quarter. These results were reported in press releases, direct communications with investors and investment analysts, and in quarterly and annual reports to the United States Securities and Exchange Commission. Qwest, through NACCHIO and others, also issued financial guidance, generally referred to as targets, to the investing public concerning Qwest's future revenue, growth, and earnings. This guidance was repeatedly reaffirmed by NACCHIO prior to September 10, 2001.
4. From the time that Qwest common stock first began to trade on a national securities exchange, Qwest had an insider trading policy prohibiting its employees, including NACCHIO, from selling Qwest common stock and other Qwest securities while in possession of material, non-public information. NACCHIO knew this policy, was repeatedly reminded of it and was advised that selling Qwest common stock while in possession of such information was a crime.
5. Qwest's business included two types of revenue: recurring revenue and non-recurring revenue. Recurring revenue was revenue that Qwest earned each month during the life of a customer as it rendered services to that customer. Non-recurring revenue typically resulted from one-time, quarter-end transactions.
6. No later than December 4, 2000, through and including September 10, 2001, NACCHIO was aware of material, non-public information about Qwest's business, including, but not limited to: (a)

that Qwest's publicly stated financial targets, including its targets for 2001, were extremely aggressive and a "huge stretch"; (b) that in order to achieve its publicly stated financial targets for 2001, Qwest would be required to significantly increase its recurring revenue business during the first few months of 2001; (c) that Qwest's past experience or "track record" in growing recurring revenue at a sufficient rate to meet its publicly stated financial targets was poor; (d) that Qwest's recurring revenue business was underperforming from early 2001 and was not growing at a sufficient rate to meet Qwest's publicly stated financial targets; (e) that there were material undisclosed risks relating specifically to Qwest's recurring and non-recurring revenue streams that put achievement of Qwest's 2001 publicly stated financial targets in jeopardy; (f) that the gap between Qwest's publicly stated financial targets and Qwest's recurring revenue was increasing, thus increasing Qwest's reliance on risky and unsustainable one-time transactions; and (g) that there would be insufficient non-recurring revenue sources to close the gap between Qwest's publicly stated financial targets and its actual performance.

7. Beginning as early as August 2000, NACCHIO was specifically and repeatedly warned about the material, non-public financial risks facing Qwest and about Qwest's ability to achieve its aggressive publicly stated financial targets.

8. NACCHIO's stock sales accelerated in January 2001 as he became aware of additional material, non-public information.

9. Beginning on or about January 2, 2001, and continuing through and including September 10, 2001, NACCHIO, in the District of Colorado and elsewhere, did knowingly and willfully, directly and indirectly, by the use of means and instrumentalities of interstate commerce and of the mails, and the facilities of a national securities exchange use and employ, in connection with the purchase and sale of a security registered on a national securities exchange, a manipulative and deceptive device, scheme, artifice or contrivance to defraud in contravention of Rule 10b-5 (17 C.F.R. § 240.10b-5) and Rule 10b5-1 (17 C.F.R. § 240.10b5-1) prescribed by the United States Securities and Exchange Commission. More specifically, NACCHIO, in furtherance of this scheme to defraud, did knowingly and willfully sell, using the instrumentalities of interstate commerce and the facilities of a national securities exchange more than $100 million worth of Qwest common stock on the dates and in the amounts set forth in Counts 1 through 42 while aware of and on the basis of material, non-public information on or about the dates and in the amounts set forth below. The allegations in paragraphs 1 through 9 above are realleged in each of the following Counts numbered 1 through 42:

Count	Trade Date	# of Shares	Sale Price per Share	Gross Sale Price
1	1/2/01	196,723	$ 39.8394	$ $7,837,326.29
2	1/3/01	160,000	$ 40.2093	$ 6,433,488.00
3	1/26/01	7,500	$ 43.2800	$ 324,600.00
4	1/29/01	92,500	$ 43.1356	$ 3,999,043.00
5	1/30/01	70,000	$ 43.3571	$ 3,034,997.00
6	2/1/01	10,000	$ 41.7500	$ 417,500.00
7	2/5/01	70,000	$ 40.2261	$ 2,815,827.00
8	2/6/01	30,000	$ 41.3967	$ 1,241,901.00
9	2/7/01	20,000	$ 41.0000	$ 820,000.00
10	2/8/01	90,000	$ 40.7822	$ 3,670,398.00
11	2/9/01	10,000	$ 40.5000	$ 405,000.00
12	2/12/01	70,000	$ 40.9857	$ 2,868,999.00
13	2/13/01	30,000	$ 41.3433	$ 1,240,299.00
14	2/13/01	180,000	$ 41.6898	$ 7,504,164.00
15	2/15/01	70,000	$ 40.1857	$ 2,812,999.00
16	2/20/01	11,500	$ 37.4763	$ 430,977.45
17	2/21/01	11,500	$ 37.3670	$ 429,720.50
18	2/22/01	11,500	$ 36.4497	$ 419,171.55

Count	Trade Date	# of Shares	Sale Price per Share	Gross Sale Price
19	2/23/01	11,500	$ 34.8355	$ 400,608.25
20	2/26/01	11,500	$ 38.1230	$ 438,414.50
21	2/27/01	11,500	$ 37.8861	$ 435,690.15
22	2/28/01	11,500	$ 37.2978	$ 428,924.70
23	3/1/01	11,500	$ 35.1291	$ 403,984.65
24	4/26/01	350,000	$ 38.8559	$ 13,599,565.00
25	4/27/01	300,000	$ 39.6716	$ 11,901,480.00
26	4/30/01	110,000	$ 41.1182	$ 4,523,002.00
27	5/1/01	100,000	$ 40.8353	$ 4,083,530.00
28	5/3/01	50,000	$ 39.0852	$ 1,954,260.00
29	5/7/01	70,000	$ 38.3086	$ 2,681,602.00
30	5/8/01	20,000	$ 38.7000	$ 774,000.00
31	5/9/01	30,000	$ 38.0000	$ 1,140,000.00
32	5/10/01	43,200	$ 38.0000	$ 1,641,600.00
33	5/11/01	20,000	$ 37.2250	$ 744,500.00
34	5/14/01	56,800	$ 37.6367	$ 2,137,764.56
35	5/15/01	105,000	$ 37.7667	$ 3,965,503.50
36	5/18/01	20,000	$ 38.0000	$ 760,000.00

Count	Trade Date	# of Shares	Sale Price per Share	Gross Sale Price
37	5/21/01	10,000	$ 38.1140	$ 381,140.00
38	5/22/01	10,000	$ 38.6027	$ 386,027.00
39	5/23/01	10,000	$ 38.2320	$ 382,320.00
40	5/24/01	4,100	$ 38.0012	$ 155,804.92
41	5/25/01	15,900	$ 38.0000	$ 604,200.00
42	5/29/01	5,000	$ 38.2500	$ 191,250.00
	TOTAL	**2,528,723**		**$ 100,812,582.02**

All in violation of 15 U.S.C. §§78j (§ 10b) and 78ff, SEC Rule 10b-5 (17 C.F.R. § 240.10b5) and SEC Rule 10b5-1 (17 C.F.R. § 240.10b5-1).

FORFEITURE ALLEGATIONS

Upon conviction of one or more of the offenses alleged in Count(s) 1 through 42 of this Indictment, NACCHIO shall forfeit to the United States, pursuant to 18 U.S.C. § 981(a)(1)(C), 18 U.S.C. § 1956(c)(7)(A), 18 U.S.C. § 1961(1)(D), and 28 U.S.C. § 2461(c), a sum of money equal to a total of

$ 100,812,582

in United States currency, representing the amount of proceeds obtained as a result of the offenses. If any of the above described forfeitable property, as a result of any act or omission of the Defendant: (a) cannot be located upon the exercise of due diligence; (b) has been transferred or sold to, or deposited with, a third party; (c) has been placed beyond the jurisdiction of the Court; (d) has been substantially diminished in value; or (e) has been commingled with other property which cannot be divided without difficulty; it is the intent of the United States, pursuant to 21 U.S.C. § 853(p) as incorporated by 18 U.S.C. § 982(b) and 28 U.S.C. § 2461(c), to seek forfeiture of any other property of NACCHIO up to the value of the forfeitable property described above.

A TRUE BILL

s/ Foreperson
FOREPERSON

s/ William J. Leone
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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

1. JOSEPH P. NACCHIO,

Defendant.

GOVERNMENT'S BILL OF PARTICULARS

The United States of America, by and through its undersigned counsel, hereby submits this Bill of Particulars pursuant to the Court's March 24, 2006 Order. This Bill of Particulars does not identify all evidence and proof that the government intends to offer at trial; rather, it provides certain information consistent with the Court's Order and Tenth Circuit case law on the purpose of a bill of particulars. *See United States v. Francisco*, 575 F.2d 815 (10th Cir. 1978). The purpose of a bill of particulars is to better inform the defendant of the *nature* of the charges against him with sufficient precision to enable him to prepare for trial and to minimize the danger of surprise at trial. A bill of particulars does not change the indictment in any way. *Id.* at 819. In addition, this Bill of Particulars does not set forth all the government's evidence because that is not required in a bill of particulars, *id.*, nor was that required by the Court's Order.

The defense has already been provided with substantial discovery, indexed and selected to help avoid surprise at trial. That discovery, which was provided to the defendant well in advance of when it would be required by statute or rule, includes the information set forth below and other evidence the government may seek to introduce at trial. The discovery includes the key exhibits selected out of the universe of available information and made exhibits before the Grand Jury, as well as Grand Jury testimony, interview memoranda of key witnesses, internal forecasts and updates, business unit presentations, and e-mail communications. The government does not intend to limit its proof by describing the nature of the case with more particularity.

1. With respect to Paragraph 3 of the Indictment: *Identify the financial guidance that the government claims was issued, including the date the guidance was issued and the specific time period the guidance covered.*

The "financial guidance" (often referred to as targets) referred to was formal guidance concerning revenue, earnings, and growth issued by Qwest in public releases from time to time. For purposes of the time period in the Indictment, the relevant financial guidance was first issued on or about September 7, 2000, remained in effect until on or about September 10, 2001, is a public document and has been provided to the defendant in discovery (QUSA 0024613-17). That guidance included 2001 revenue between $21.3 and $21.7 billion, EBITDA of $8.5-8.7 billion, five year compounded growth targets of 15-17% for revenue and 20% for EBITDA, and other performance metrics that

are derivative of or included within this guidance, such as earnings per share.

That same guidance was reaffirmed from time to time in a variety of ways, including, without limitation, in SEC Filings such as Form 8-Ks, press releases, during both regular and periodic audio/video earnings and investor conference calls, and in conversations with analysts and investors, all of which have been provided to the defendant in discovery.

The Court's Order does not extend to instances on which the guidance was reaffirmed. However, to assist the defendant's preparation, and without limiting the instances on which the defendant or others acting on his behalf reaffirmed the formal financial guidance issued on September 7, 2000, that guidance was frequently reaffirmed, including on or about the following dates:

A. September 8, 2000
B. October 24, 2000
C. October 25, 2000
D. October 31, 2000
E. November 3, 2000
F. December 21, 2000
G. December 22, 2000
H. January 23, 2001
I. January 24, 2001
J. January 25, 2001
K. February 26, 2001
L. February 27, 2001
M. March 13, 2001
N. March 15, 2001
O. March 22, 2001

P. March 29, 2001
Q. April 24, 2001
R. April 25, 2001
S. April 26, 2001
T. April 27, 2001
U. May 25, 2001
V. June 5, 2001
W. June 19, 2001
X. June 20, 2001
Y. June 22, 2001
Z. July 24, 2001
AA. July 26, 2001
BB. August 7, 2001
CC. August 22, 2001

2. With respect to Paragraph 6: *Identify when the defendant became aware of all of the material non-public information the government claims the defendant was aware of between December 4, 2000 and September 10, 2001.*

The Indictment alleges a required element of insider trading, specifically, that the defendant was aware of material non-public information, and then describes that information by category in paragraphs 6(a) - 6(g). The government understands that the Court's Order, set forth at pp. 29-31 of the March 24, 2006 hearing transcript, requires it to further elaborate on the general descriptions of material inside information set forth in paragraphs 6(a) - 6(g) as specified by the Court, but not to specify all of its evidence.

By way of further particularization, in 2001, at the times set forth in the Indictment in each count, the

defendant was aware of material, non-public information about Qwest that triggered a duty to abstain from selling his stock. In the most general sense, the government contends that at the time the defendant sold his stock, he knew the risk of an investment in Qwest was materially greater than what the public knew based on publically available information. The defendant knew the true risks because he was privy to material, non-public information about Qwest. The information known to the defendant regarding the true risk of an investment in Qwest stock was a combination of non-public historic information, internal assessments of Qwest's business prospects, and actual operating results beginning in January 2001, that deviated from the internal plan that supported Qwest's public financial guidance. The defendant became aware of this information over time. Generally, as the internal updates and analysis about Qwest's business increasingly worsened, the defendant sold his stock at an increasing rate. For example, in the 16 months prior to January 1, 2001, and following the announcement of the Qwest/US West merger, the defendant sold approximately $106 million in stock. Conversely, in the five months of sales charged in the Indictment, from January 2, 2001 to May 29, 2001, the defendant sold in excess of $100 million in stock. *See* Exhibit A attached hereto.

The government will present the material non-public information known to the defendant over time against this backdrop of accelerated sales. It will be for the jury to determine the point at which the information in the defendant's possession was of sufficient importance that a reasonable shareholder would want to know it and whether the defendant

unlawfully took advantage of the fact that the investing public was unaware of this material information. The Indictment alleges that the warnings and information received by the defendant prior to January 2, 2001, was sufficient to trigger the duty to abstain or disclose.

No later than January 2, 2001 (the date of the sales alleged in Count 1), Defendant Nacchio knew of the information alleged in paragraphs 6(a)-(c), (e) and (g). That information included that Qwest's targets for 2001 were a significant stretch, that recurring revenue would have to increase significantly by March and April for Qwest to meet its budget targets and Wall Street guidance for 2001, that Qwest had a poor historical record of growing its recurring revenue sources, and that there would not be sufficient non-recurring revenue sources to fill the gap between Qwest's actual recurring revenue performance and its financial guidance, whereas historically Qwest had met its targets by utilizing large non-recurring transactions.

The material inside information of which the defendant was aware no later than January 2, 2001, includes information he learned as early as January 2000, that Qwest was not meeting its recurring revenue forecasts and was reliant on quarter-end non-recurring transactions. It includes information received in August 2000, following the Qwest/US West merger when the defendant met with Qwest business unit heads, including the heads of Consumer/National Mass Markets, DEX, Wholesale, and Global Business, and was advised of numerous risks with respect to Qwest's 2001 financial targets. It includes information received by the defendant during the budgeting process that took place between October and

December 2000, in which defendant was further advised of material risks to achieving Qwest's 2001 targets, including Qwest's non-public forecast that non-recurring revenue would decline precipitously in 2001.

The negative material inside information of which defendant was aware, culminated in severe, specific, warnings received by the defendant in December 2000. The government intends to present substantial evidence that warnings similar to those set forth below, were conveyed to the defendant orally and in writing, by multiple witnesses, and in multiple contexts prior to the date of the first sale charged in the Indictment. Although the government does not intend to limit its evidence, the key material inside information is summarized in written memos provided to the defendant in December 2000, in which he is warned that: (1) "If we don't crank up recurring revenue growth by April, we got big problems"; (2) "There won't be enough one-timers to close the gap in Q3 and Q4 if recurring revenues don't take off"; (3) As much as $587 million in "one time revenue" would be needed for the first quarter alone; (4) "If the economy slows down, recurring revenue growth could be at big risk"; (5) "one time things... cannot continue"; (6) "We need recurring to take off big time by the end of the first quarter or we are screwed"; (7) "The revenue and EBITDA numbers for next year are a huge stretch"; (8) "We need recurring business to literally take off by April-May time frame or the amount of one time business required to fill the gap will just be too large to deal with"; (9) "Our track record in this area [growing recurring revenue business] is not good as you know"; and (10) "If we don't develop new products we have a big risk in making the top line."

After January 2, 2001, the defendant continued to receive similar warnings. In addition, the defendant became aware of the material inside information described in paragraphs 6(d) and (f) after January 2, 2001. These categories of material inside information relate to actual results of Qwest's business operations. The defendant learned of the true status and performance of the business after January 2, 2001, in numerous ways, formal and informal, including discussions with business unit heads and others, discussions with other Qwest executives including investor relations and finance personnel, in formal quarter-end and informal interim business unit reviews, and from documentary presentations. Evidence related to this information has been provided to the defendant in discovery. Such documents include, by way of example only, business unit forecast updates, business initiative sheets, business unit review updates, and earnings release binders.

The government does not understand the Court's Order to require it to identify all of its evidence with respect to paragraphs 6(d) and (f). However, without limiting its proof at trial, and by way of providing further particulars, the defendant knew from early in 2001 through September 2001, that the business units were underperforming with regard to their specific internal budgets, and that such under-performance would inhibit Qwest's ability to meet its 2001 financial guidance issued on September 7, 2000. More specifically, the defendant learned that (1) Qwest's recurring revenue business was underperforming against plan and that sales were weak in numerous product lines including hosting, long distance, local, private line, consumer, Qwest interactive, switched

services, ISDN, wireless, global business, DEX, hosting, DIA (dedicated internet access), and virtually all core IP/Data business; and that (2) Qwest's ability to complete one-time non-recurring transactions, especially in the 3rd and 4th quarters was materially deteriorating and would be insufficient to offset underperformance in recurring revenue units.

3. With respect to Paragraph 6(a): *Identify the financial targets referred to in this paragraph.*

The financial targets are those set forth in response number one above.

4. With respect to Paragraph 6(b): *Identify the financial targets referred to in this paragraph.*

The financial targets are those set forth in response number one above.

5. With respect to Paragraph 6(c): *Specify or identify the "past experience" or "track record" referred to in this paragraph.*

Qwest's "past experience" or "track record" was that Qwest's recurring revenues did not meet Qwest's historic plan for recurring revenue and did not grow at a rate sufficient for Qwest to meet its overall revenue targets. As early as 1999, Qwest tracked and reported to the defendant its recurring revenue performance against its recurring revenue plan. Historically, Qwest underperformed against its internal plan with respect to recurring revenue and achieved its aggregate financial guidance only by doing non-recurring revenue deals at the end of each quarter.

6. With respect to Paragraph 6(b): *Identify which financial target would not be met.*

The financial targets that would not be met were the revenue, earnings, and growth targets first provided on September 7, 2000, and re-affirmed on at

least the occasions set forth in response number one above.

7. With respect to Paragraph 6(e):

a. *Identify the material undisclosed risks referred to in this paragraph.*

Paragraph 6(e) is intended to put the defendant on notice that in addition to the specific information described elsewhere in paragraph 6 and further particularized in response number 2 above, the government alleges that he was aware that Qwest's business was experiencing other difficulties that posed a significant risk to Qwest's ability to achieve its public financial targets. Those difficulties are described in the discovery provided to the defendant. Those difficulties include the risk that by missing 2001's targets, future targets would be jeopardized. Those risks also include the fact that Qwest's business was impacted negatively by the deteriorating economy, reduced demand, pricing pressure, and increased competition.

b. *Identify which financial targets were in jeopardy.*

The financial targets identified in response number one above were in jeopardy.

c. *Identify in what way the risks put the financial targets in jeopardy.*

On several occasions, including those set forth in response number one above, the defendant asserted, or caused to be asserted, that Qwest's business was not impacted by the risks identified in response 7(a) above. In fact, the defendant knew that Qwest's business was impacted thus making it less likely that Qwest would achieve its financial targets.

8. With respect to Paragraph 6(f):

a. *Identify the gap or specify the gap, not necessarily in numerical terms.*

The "gap" is the difference between Qwest's publicly stated financial targets described in response one above and the actual recurring revenue performance, *i.e.*, actual recurring revenue generated.

b. *Identify the specific financial targets referred to in this paragraph.*

The financial targets referred to are those set forth in response number one above.

c. *Identify the recurring revenue referred to in this paragraph.*

As set forth in paragraph 5 of the Indictment, Qwest's recurring revenue was revenue other than what its documents classified as non-recurring. Recurring revenue consisted of revenue that Qwest earned each month during the life of a customer as it rendered services to that customer. Non-recurring revenue consisted almost entirely of IRU and equipment sale revenue.

d. *Identify the increase referred to in this paragraph.*

The difference between Qwest's publicly stated financial targets and Qwest's recurring revenue could only be filled by non-recurring one time deals. The increase referred to is the increase in the amount of revenue that Qwest would have had to have generated from non-recurring, one-time transactions to make up the difference between its recurring revenue and its publicly stated financial targets.

e. *Identify the risky and unsustainable one-time transactions that are referenced in this paragraph.*

The risky and unsustainable one-time transactions were primarily capacity sales known as IRUs (indefeasible rights of use) and equipment sales.

9. With respect to Paragraph 6(g): *Identify the risky and unsustainable one-time transactions Qwest was relying on.*

There is no reference to risky and unsustainable one-time transactions in paragraph 6(g). However, the non-recurring revenue sources referred to were primarily IRUs and equipment sales.

10. With Respect to Paragraph 8: *Identify the additional material, nonpublic information that the defendant learned in January of 2001.*

The material non-public information alleged in paragraph 8 is included in the material non-public information alleged in paragraph 6, as more particularly set forth in response number two above.

Respectfully submitted this 10th day of April, 2006.

WILLIAM J. LEONE
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s/William J. Leone
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ATTORNEYS FOR THE
GOVERNMENT

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME ONE

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 12:04 p.m., on the 20th day of March, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[3]

* * *

PROCEEDINGS

THE COURT: Good afternoon, members of the jury. We're ready to hear the opening statements of the lawyers.

Mr. Hearty.

OPENING STATEMENT

* * *

[8]

core recurring business at twice the rate that it had grown in 2000; that is, it would have to double its rate of growth when economic conditions at that time were driving the prices down for many of Qwest's products.

Now, inside Qwest, Mr. Nacchio knew about those risks. However, outside Qwest, investors didn't.

Now, by April of 2001, Mr. Nacchio knew that the risk that Qwest would not be able to achieve the growth targets that he told investors to expect was even greater, because by April 2001, Mr. Nacchio had the results of how Qwest had actually performed in the first three months of the year. And what he knew is that Qwest was not growing at a rate that was sufficient to hit the yearly targets that he had told investors to expect.

He was also told during that time period that the way that Qwest had made its numbers in the past, that is, the way that Qwest had achieved the growth targets that they told investors to expect, were large, one-time transactions, and he was told that in the second half of 2001, not to count on large, one-time transactions to make the numbers.

Now, inside Qwest, Mr. Nacchio knew of those risks. But outside Qwest, investors didn't.

Now, with the benefit of knowing these risks, risks that the public did not know, Mr. Nacchio sold $100 million worth of Qwest stock. And you will hear that keeping the

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME SIX

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 8:42 a.m., on the 26th day of March, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[698]

* * *

COURTROOM DEPUTY: Please be seated.

Please state and spell your full name for the record into the microphone.

THE WITNESS: Robin R. Szeliga, R-O-B-I-N, R, S-Z-E-L-I-G-A.

DIRECT EXAMINATION

* * *

[744]

THE COURT: Proceed. Unless—do you have a non-hearsay purpose in mind?

MS. CONRY: Well, it's her statement. She's here and available for cross-examination, I think Mr. Woodruff's statements—

THE COURT: Makes no difference.

MS. CONRY: All right.

THE COURT: To Mr. Woodruff, that is.

BY MS. CONRY:

Q. Did you ever talk to anyone else about this memo?

A. Yes, I did.

Q. Who?

A. Talked to my employees in the financial planning and analysis. And later on in the year, I brought up the billion dollars of risk again. And that time I brought it up to both Mr. Woodruff and Mr. Nacchio together.

Q. Okay. And let's focus on that conversation with Mr. Woodruff and Mr. Nacchio. And to be clear, did you have the memo in your hand when you went to talk to them?

A. I don't believe I took it with me, no.

Q. Okay. Where did the conversation take place?

A. I believe it was in Mr. Nacchio's office or conference room on the 52nd floor.

Q. And when did this conversation take place?

A. Mid to late December, into early January. I can't pinpoint **[745]** a date.

Q. And what prompted you to discuss this, at least the topic, of this memo with Mr. Woodruff and Mr. Nacchio at that time?

MR. STERN: Object to that question. Not to the conversation.

THE COURT: As to what prompted it?

MR. STERN: Yes, Your Honor. Her state of mind isn't an issue, I don't believe.

THE COURT: All right. Why are we getting into this?

MS. CONRY: Trying to explain her actions. Let me—I can go at it a different way, if that's easier.

THE COURT: All right. The objection is sustained.

MS. CONRY: Okay.

BY MS. CONRY:

Q. What were you doing right before you went in and talked to Mr. Nacchio and Mr. Woodruff, what sorts of business activities were you doing?

A. In mid to late December, we were trying to finalize our budgets for 2001.

Q. Okay. And what were you doing as a part of that?

A. Communicating where we were on the budget to Mr. Woodruff and Mr. Nacchio, Mr. Mohebbi, and discussing each of the business unit's budgets with them in the wrap-up phase of the budgeting process for 2001.

Q. So following this wrap-up phase of the budget process, you **[746]** went to Mr. Woodruff and Mr. Nacchio to discuss this billion dollars in risk; is that right?

A. That's correct.

Q. Okay. As best as you recall, can you tell the jury what you told Mr. Woodruff and Mr. Nacchio in that meeting?

A. I explained to Mr. Woodruff and Mr. Nacchio that the business units were still concerned, very concerned, that they could not meet the targets that had been assigned to them and that when we heard their concerns being, we, the corporate planning function, and we aggregated all the risk they were identifying, we were still at this time coming to a billion dollars of risk as it related to the target that we had set.

Q. Okay. And what was Mr. Nacchio's response?

A. In general, he told me that although it was my responsibility to add the numbers up, that he would make the determination, not me, as to whether there—the business units had valid concerns or not.

Q. And did the target go down following your meeting with Mr. Nacchio and Mr. Woodruff?

A. No, it didn't.

Q. All right. Let's focus back now in time, closer in time to the date of this memo, which was September 5, 2000, right.

Do you know whether—let me ask you, at that time, how comfortable were you with your plan for 2000? How far along were you?

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME SEVEN

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 1:10 p.m., on the 26th day of March, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[787]

* * *

P R O C E E D I N G S

MS. CONROY: Thank you, Your Honor.

(ROBIN SZELIGA, GOVERNMENT'S WITNESS, PREVIOUSLY SWORN)

DIRECT EXAMINATION CONTINUED

* * *

[823]

* * *

Q. And what I'm focusing on, on the annual shortfalls in private line and those other areas, how does that relate to the discussion that you had with us earlier regarding the rule of 78s?

A. Well, for the most part, if you look at the products that are listed, private line, hosting, wireless and local services, those are recurring revenues. And so these were some of the bigger growth products in our business plan that we needed to start growing out of the gates right away in order to build up the blocks to make our ultimate goal of year-end revenue for our budget?

Q. So how did you plan looking forward at the time of this update, how did the risk of that plan compare to your original budget?

A. I would say it was as risky or riskier. The explanation I would give for that is when we originally presented the budget and I articulated that I thought we had a billion dollars of risk built into the stretch targets, we're a month into the year, we've seen what has happened in terms of our growth products, and they're not kicking off the way we needed them to in order to make our plan.

So it felt much more imperative to get focused on this than it did three months earlier, because this is exactly what we didn't want to have happen.

* * *

[867]

* * *

Q. Ms. Szeliga, were you ever able to finally convince Mr. Nacchio to take down the number?

A. Yes.

Q. When?

A. Mr. Nacchio took down the number September the 10th, 2001.

Q. Okay. And when did you first—in that time setting, when did you broach him to discuss that topic?

A. We presented Mr. Nacchio a presentation on August the 15th, and in that presentation, we presented what I considered enough information to convince him to take down the numbers. So I recommended to him at that time, we need to take our numbers down.

Q. And what was his initial response?

A. He wanted to look at the detail. And then he wanted to have business unit reviews to hear from the business units, where they were, as a result of what I was showing them and their current estimates built into that particular presentation, he wanted to talk to the individual business units and confirm or disavow me of the fact that they were [868] saying they couldn't make their numbers. So he asked for those business unit reviews to take place.

Q. And did you participate in those business unit reviews?

A. Yes, I did.

Q. And over what time period did those take place, do you recall?

A. Between August the 15th and the end of August.

Q. And when the—

A. Excuse me. I think they actually ran into early September.

Q. Okay. And when the company finally took down its numbers, did they issue a press release?

A. Yes.

MR. STERN: What?

BY MS. CONRY:

Q. I'm sorry, did it issue a press release, Mr. Stern. Take a look at Government's Exhibit 646.

A. Yes, I have it.

Q. And what is it?

A. It's a press release from Qwest that was issued September 10, 2001.

Q. And what was your role in preparing this press release?

A. I reviewed it and made comment to it, as I did with other press releases.

Q. What was Mr. Nacchio's role in this press release?

A. He reviewed it and made comments as well, to the best of my [869] recollection.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME EIGHT

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 8:47 a.m., on the 27th day of March, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[931]

* * *

(ROBIN SZELIGA, GOVERNMENT'S WITNESS, PREVIOUSLY SWORN)

CROSS-EXAMINATION CONTINUED

* * *

[935]

THE COURT: Overruled.

BY MR. STERN:

Q. Now, Ms. Szeliga, the street guidance that we're talking about is another way of saying publicly stated financial targets; is that right?

A. Yes, I believe that's correct.

Q. And as of the time, that is April of 9th, 2001, the publicly stated financial targets for Qwest for the year 2001, the end of year 2001, was a range of between 21.3 billion and $21.7 billion; is that correct?

A. Yes.

Q. Now, even as of April the 9th, with all of the debates that you have told us about, the internal current view of Qwest was that they would reach $21.5 billion by December 31st, 2001. That's correct, isn't it?

A. I think so, yes.

Q. Now, these were publicly stated financial targets which had been issued on September the 7th, 2001, correct?

A. Give me the date again, please.

Q. September 7, 2000.

A. Yes, sir.

Q. Yes. And those projections were for 16 months into the future, correct, roughly?

A. Yes.

Q. And those projections were based on a study which had been

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME NINE

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 1:15 p.m., on the 27th day of March, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[1032]

* * *

PROCEEDINGS

THE COURT: All right, Ms. Conry.

MS. CONRY: Thank you, Your Honor.

(ROBIN SZELIGA, GOVERNMENT'S WITNESS, PREVIOUSLY SWORN)

REDIRECT EXAMINATION

* * *

[1034]

* * *

Again, just to orient the jury, this is a memo you received on or around September 5, 2000; is that right?

A. Yes.

Q. Okay. And you discussed this with Mr. Nacchio, I think you told us in your direct, sometime between December and—of 2000 and February of 2001?

A. I discussed the billion dollar risk with Mr. Nacchio at that time, not this—not the specifics of this memo, necessarily.

Q. Right, okay. We talked about, you didn't have it with you?

A. I did not.

Q. Terrific. The total budget here—I'd like to start out with, you referenced the difference between the $22 billion target and the 21.6 street disclosure.

A. Yes.

Q. What I'd like to do, sorry, is walk through the 22 billion is the budget, right?

MR. STERN: Excuse me, Your Honor. There was no street disclosure. This is dated September 5. And I believe the witness testified that it did not refer to street disclosure. But I'm having the record checked, even though it says it there, because you know the street was September 7.

THE COURT: This is confusing.

[1035] If you were talking about—are you talking about the September—February 16 disclosure?

MR. STERN: No, Your Honor, the—

THE COURT: I was asking Ms. Conry.

MR. STERN: Okay.

THE COURT: In her question, she talked about the February 16 street disclosure.

MS. CONRY: I apologize, I misspoke.

THE COURT: Let's start over again. Because I think that was the basis of your objection, there was no street disclosure—

MR. STERN: Yes—

THE COURT: —after a certain point.

MR. STERN: But we're coming to the point, if you look at the date of this memo that's on the screen, you'll find that it's dated September 5.

THE COURT: All right. Well, thank you, for that.

MS. CONRY: We'll stipulate.

THE COURT: Proceed.

MS. CONRY: September 5.

THE COURT: Start over.

MS. CONRY: I will, and I'll slow down, I apologize, Your Honor.

BY MS. CONRY:

Q. So the internal target was 22 billion, according to this **[1036]** memo; is that right?

A. Yes.

Q. Okay. And then there is a $400 million difference between that target and what this says was the street disclosure; is that right?

A. Yes.

Q. Okay. I think you called that the cushion before; is that right?

A. Yes.

Q. And that comes down to 21.6 billion. And we'll just call that—I think the memo calls it the street

disclosure, so I'll use that same number—is that all right with you—that same description?

A. That's fine.

Q. Okay. And this memo, if you can highlight the 1,192,000, 000, what does Mr. Bickley describe that as?

A. Grand total risk in street disclosures, 1,192,000,000.

Q. I'm going to round that to 1.2 billion; is that fair?

A. Yes.

Q. And I'm going to call that risk.

So when I take the street, according to this memo, minus the risks, what do I come to?

A. 20 billion .4.

Q. 20.4 billion, all right. Street minus the risk is 20.4 billion. And I want to compare that to the guidance that **[1037]** Mr. Nacchio gave to the street two days after this, okay.

A. Okay.

Q. Okay. So September 7, 2000, guidance at the top end was, what?

A. 21.7 billion.

Q. And at the bottom end was what?

A. 21.3 billion.

Q. High, low. So what is the difference between the street minus the risk, this net number, 20.4 billion, when you fact in the risk, how does this number compare to the high end?

MR. STERN: I object, Your Honor.

THE COURT: Overruled.

THE WITNESS: It is—it is $1.3 billion lower.

BY MS. CONRY:

Q. And how does this number, 20.4 billion, compare to the low end of the guidance that Mr. Nacchio disclosed to the street?

A. About $900 million lower.

Q. Okay.

A. That would be .9 billion, not million, if I'm reading that right.

Q. Sorry. Okay. So to be clear, the guidance is higher both on the low end and the high end when you factor in your 1.2 billion in risk; is that right?

A. Yes.

* * *

[1108]

Q. Okay. When was the first time that you had a formal [1109] meeting with Mr. Nacchio where you reported to him on the performance of your division and then also included projections for your division for the remainder of 2001?

A. April—in April. We had a meeting that was called a business unit review, and it was the first quarter review. We had done that since we started at Qwest. And basically, what it was, is that—the business units had—business units head was able to communicate with Joe, you know, what the status of the business unit was, as well as reporting on the results for the previous quarter, in this case, the first quarter.

Q. And so this would be early April, after you had your first quarter numbers, is that the way it worked?

A. Yes.

Q. And in your—so did you have such a meeting with Mr. Nacchio in early April?

A. Yes, I did.

Q. And what was the most important message that you wanted to deliver and did deliver to Mr. Nacchio during that meeting?

A. Exactly what I said before, that, A, the IRU market was drying up, that after the second quarter—in the second quarter, we felt like we were draining the pond in terms of the IRU deals that were out there, and that we couldn't rely on IRUs—I couldn't see—have any visibility to what IRUs would be doing after the second quarter.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME ELEVEN

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 1:33 p.m., on the 28th day of March, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[1301]

* * *

(GRANT GRAHAM, GOVERNMENT'S WITNESS, PREVIOUSLY SWORN)
CROSS-EXAMINATION CONTINUED

* * *

[1315]

Q. Now, to the right of that, these—it reflects numbers that are both forecasted and budgeted.

A. Yes.

Q. Those numbers are constantly changing; is that correct?

A. Yes.

Q. Which only shows that the forecasting process has limitations, because the numbers are constantly being updated, right?

A. I don't think it's a representation of the forecasting limitations. I think it's a representation of the moment in time that you do another forecast and the information you use to produce the forecast.

Q. All right. And it's always changing, isn't it?

A. No, it's not necessarily always changing. And in this case, in this year, it was.

Q. Well, that's what we're looking at right here. These numbers change from forecast to budget, right?

A. From forecast view to forecast view, the numbers had a tendency to change.

Q. All right. You're not saying that you're guaranteeing the future, are you?

A. No. The representation of the forecast was providing our best belief of what things were going to happen.

Q. What share of—if you don't know the number, what share of that Microsoft deal did global business participate in, if

* * *

[1427]

MR. STRICKLIN: And then—

THE COURT: Go through Thursday.

MR. STERN: I couldn't hear you.

MR. STRICKLIN: We'll reconvene on Tuesday, then?

THE COURT: Yes.

MR. STERN: So we're off Monday—Monday at 4:00.

THE COURT: At 4:00.

MR. STERN: That's great.

THE COURT: You can go to eat gefiltefish.

MR. STERN: I don't like gefiltefish.

THE COURT: I do.

MR. STERN: Maybe I can change.

THE COURT: All right.

MR. STRICKLIN: And the second is—I know we've buried you in paper, but Mr. Weinstein is going to testify tomorrow, probably—my guess is right before lunch or after lunch, I think we'll handle that. I just want to be heard—

THE COURT: You would like a ruling?

MR. STRICKLIN: Actually, I would like about two minutes of an argument before a ruling. Unless you're going to rule in my favor already, then I'll sit down right now.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME NINETEEN

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 1:37 p.m., on the 4th day of April, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[2447]

MR. STRICKLIN: And just in response—well—

THE COURT: I just—I think—

MR. STRICKLIN: I totally understand the—understand the Court's position, and I don't disagree with that.

THE COURT: Okay. I don't think I need argument on any of the other mistrial motions.

MR. STERN: I'm sorry?

THE COURT: I don't need argument on the other mistrial motions. I think they're clear enough, or the alternative motions, of course.

So I think what we should do is get here at 8:45 tomorrow morning, and I'll try to resolve all of these quickly, these mistrial motions.

MR. STRICKLIN: What about Mr. Fischel? We have some work to do—

THE COURT: You know, I just haven't had a chance to look at it. It's hitting pretty fast.

I have formed some preliminary views, but they really haven't jelled to the point where I want to—

MR. STRICKLIN: He'll be on the stand tomorrow, so—I didn't place him in that order. I just know—

THE COURT: Is that right?

MR. SPEISER: That's correct, Your Honor.

THE COURT: So he's your first witness?

MR. SPEISER: He's our third witness.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME TWENTY

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 8:34 a.m., on the 5th day of April, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[2351]

* * *

P R O C E E D I N G S

THE COURT: Good morning. I understand this is earlier than I announced we would start. It occurred to me as soon as counsel was here, we ought to proceed in order to avoid any possible delay in the start of the continuation of the jury trial at 9 o'clock.

There are a number of pending motions.

* * *

[2354]

The Court is mindful of the Supreme Court cases articulating the definition of materiality. Basic Inc. v. Levinson said that materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information.

In other words, in order to be material, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having altered the total mix of information made available. The basic test for materiality is whether a reasonable man would attach importance in determining his choice of action in the transaction in question.

And I mention that not only because this goes to the prosecution's evidence from these investors, but it also goes to evidence that the defendant evidently is going to offer in the form of its expert witness.

In the Court's view, all of this kind of testimony is superfluous. The Court would analogize this to a case—a simple negligence case, where a jury is asked to determine whether the—a person who is allegedly negligent took an action a reasonable man would take or failed to take an action a reasonable man would not take in order to avoid harm to himself or others.

In that type of case, you don't put the facts of the act or incident in question to a hypothetical reasonable man **[2355]** and say, what would you have done under these circumstances? You present the facts, and you allow the jury to act as the hypothetical reasonable man, interpreting those facts.

And that's the Court's view of what should happen in this case.

The facts are out, at least part of the facts are out at this point.

The question is whether in light of all that was disclosed and all that wasn't disclosed and in light of all the other circumstances a reasonable man or a reasonable person would regard the non-disclosure as material. And that is something that the jury can decide on its own without the necessity of having investors come in and give the jury their opinion on what is material and without having an expert come in and give the jury his opinion on what is material.

* * *

[2382]

* * *

THE COURT: You want to permit the Government to **[2383]** reopen its case and recall him?

MR. RICHILANO: No, Your Honor.

THE COURT: Then what are you asking?

MR. RICHILANO: I'm putting on the record the difficulty we have with this witness not cooperating with us. With the Court—

THE COURT: I don't think that affects anything.

MR. RICHILANO: Would the Court enter an order requiring him to talk to us before his testimony?

THE COURT: No, there is no basis for this Court to order any witness to talk to either party. The fact that the witness chooses to talk to one side and not to the other side is something that you can use, and have used extensively, in cross-examination of the witness to show bias. But there is no basis for a Court order. If you've got a single case that tells me I can do that, I'm happy to entertain it.

Get the jury—I know I have the motion on the expert testimony, but we're already a half hour overdue with the jury, and I know you want a ruling, Mr. Stricklin, but—who's going to examine Mr.—

MR. STRICKLIN: We've got Mr. Traskos for that, Your Honor.

THE COURT: Really? Mr. Wise has taken a shot at him before.

* * *

[2414]

* * *

(ABBOTT GILES PETER HAYES, DEFENDANT'S WITNESS, SWORN)

* * *

[2420]

* * *

CROSS EXAMINATION

* * *

[2426]

Q. And it's something we all share; is that right?

A. That's correct.

Q. And you've also learned in your work, sir, isn't it true, that good people can do bad things?

MR. SPEISER: Your Honor, this is really out of line.

THE COURT: Sustained.

MR. STRICKLIN: I'll have nothing further, Your Honor.

THE COURT: I take it the objection is that it's argumentative.

MR. SPEISER: Yes, Your Honor.

THE COURT: All right. Do you have redirect?

MR. SPEISER: No, Your Honor.

THE COURT: All right. Sir, you may step down. You're excused from further appearance in the case.

Who is your next witness?

MR. SPEISER: Daniel Fischel.

THE COURT: All right. Members of jury, I need to make some legal rulings at this time.

Unfortunately, I'm just going to have you remain in your jury room while that happens.

So I'll ask you to retire to your jury room.

(Jury out at 10:49 a.m.)

THE COURT: The Court will take up at this time the **[2427]** motion of the Government, document No. 334, to exclude the testimony of proposed defense witness, Professor Daniel Fischel.

The Government has filed a 63-page motion. The Court has read the motion. The Court has read Mr. Richilano's letter purporting to outline the Rule 16 information required of a proponent of expert testimony. And the Court has also received and reviewed the brief reply filed by Mr. Nacchio.

To summarize, the Government charges that the defense expert disclosure does not comply with the Federal Rules of Criminal Procedure. It argues that the testimony is inadmissible under Rule 602, 403, 702, and 703 of the Federal Rules of Evidence. The Government argues that this—the testimony consists of a recitation of facts not within the witness' personal knowledge. The Government argues that the testimony is not necessary and will not help the jury. It argues that Mr. Fischel is not a qualified expert. It argues that the defense has not established that the

witness used a reliable methodology in reaching his opinions. And it argues that the facts upon which Fischel relied in making his opinion are not the ones upon which a reasonable expert would rely.

In the Court's view, the deficiencies under Daubert and Kumho Tire in these disclosures are so egregious that they hardly warrant the 63 pages of ink the Government has spilled in opposing the testimony. The testimony is excludable on a [2428] number of rationales.

Most convincingly, the defendant has made no attempt to comply with Rule 702 or Daubert and establish that Fischel's testimony is the product of reliable principles and methods or that Fischel applied some principles and methods reliably in this case.

Rule 702 governs this issue. It provides that if specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert may testify in the form of opinions if the testimony is based on sufficient facts or data; two, the testimony is the product of reliable principles and methods; and, three, the witness has applied the principles and methods reliably in this case.

The leading cases in this area, which Rule 702 was amended to reflect, require that when the factual basis, data, principles, methods or application of an expert's testimony are called into question, the trial judge must determine whether the testimony has a reliable basis in the knowledge and experience of the relevant discipline.

Daubert itself involved scientific testimony. As is relevant here, the Court in Kumho Tire expanded the Daubert analysis to include expert analysis based on technical or other specialized knowledge.

The Kumho court held that the test of flexibility **[2429]** is flexible and Daubert's list of factors neither necessarily nor exclusively applies for all experts or in every case.

The importance of an expert's methodology in arriving at a opinion is long and well established in the law. As the Supreme Court noted in Daubert, the inquiry is a flexible one. The focus, of course, must be solely on principles and methodologies, not on the conclusions they generate.

Pursuant to Tenth Circuit case law, any step that renders the analysis unreliable renders the expert's testimony inadmissible.

The defendant's only representation on this issue is that, and I quote, "Professor Fischel has completed extensive review of SEC filings, press releases and other financial data and applied his academic study and professional experience in economics and the public market to formulate opinions."

The Court finds this to be woefully inadequate to satisfy Rule 702. Indeed, as the advisory committee notes state, if the expert witness is relying solely on experience, then the witness must explain how that experience led to the conclusion reached, why the experience is a sufficient basis for the opinion, and how that experience is reliably applied to the facts in this case.

Simply put, nothing in Daubert or the Federal Rules of Evidence requires a district court to admit opinion testimony that is connected to existing data only by the ipse dixit of **[2430]** the expert, and that is precisely what we have here.

The Court is concerned not only with the methodology, which is absolutely undisclosed in this expert disclosure, the Court is concerned that the Rule 702 stipulation that the testimony must be helpful to the jury is not met here.

First, many aspects of the testimony are simply nothing more than closing argument meant to rebut a suggestion in a government closing argument or to buttress or repeat or foreshadow an argument in the defense closing argument.

For example, he is—he has alleged—it is alleged that he is going to testify that the defendant did not have an incentive to trade on the basis of inside information.

All that factual material is before the Court as to whether he did or did not have an incentive to trade on inside information. For example, with respect to the growth shares, there has been examination on that. Argument can be made one way or another by the attorneys. And the jury does not need to have an expert opinion to assist it in deciding whether there was an economic incentive to trade or not trade on inside information here.

Another example is that the proposed expert is supposed to be testifying on the fact that the defendant's sales did not increase during the relevant period of time. Whether he has an opinion as to whether they increased is neither here nor there. It's essentially irrelevant.

[2431] The Government has presented a summary testimony tending to show, if believed, that the sales and the rate of sales and the rate of money made increased in the first six months of 2001. The defendant has already cross-examined on that issue

and brought out facts from which the jury could believe that the prosecution's summary is essentially a spin.

If the defense wants to do a similar summary and spin it differently, the defense may do so. It may not spin it differently by offering the testimony of an expert who purports to offer an opinion or a conclusion that the jury can draw from other evidence in the case.

The Court is also concerned that this would not be helpful to the jury because a lot of what this man is proposed to testify to is within the common knowledge of the jury and can be—is a conclusion that the jury can draw based on argument and the evidence in the case.

For example, the expert is proposed to testify that Mr. Nacchio's investments were consistent with the economics of diversification.

Well, now, that's a piece of elucidation we really don't need here. The issue about diversification in this case, the prosecution claims that he was already diversified, and they presented evidence to that effect. The defendant contends with substantial support from Mr. Weinstein that he was not diversified, and that he was being constantly advised to **[2432]** diversify further.

The jury simply doesn't need this so-called expert witness to testify that diversification is an issue in this case. It is a subject which is properly the subject matter of argument by counsel.

A large portion of this testimony is simply irrelevant.

For example, the expert proposed—proposes to point out that at the same time Mr. Nacchio was selling other people within Qwest were selling also. And also he's going to point out, evidently, that Michael Eisner

was selling his Disney stock and Mr. Dell was selling his stock in Dell at the same time. It's so wide afield that it's almost preposterous he would be testifying about Michael Eisner or Dell.

As to the fact that other directors were selling in the meantime, the Court is puzzled as to how that can be relevant in this case. If other directors were selling—and many of the insiders have been prosecuted, or at least some of the—insiders have been prosecuted—that's neither here nor there as to whether this defendant is guilty of willfully and in bad faith selling on inside information.

Finally, the Court is concerned that this is not helpful to the jury and should be excluded under Rule 403.

It would be a needless presentation of evidence. It would lead to delay and waste of time. It would mislead the **[2433]** jury, in the Court's view.

As I've reiterated, the bulk of these conclusions are conclusions which the jury can draw after hearing the arguments back and forth. They don't need an expert witness. And what the Court is apprehensive about is that the defense will be, in effect, inviting the jurors to abandon their own common sense and common experience and succumb to this expert's credentials.

Finally, the Court is persuaded by the argument that the bulk of this testimony is simply a recitation of facts which is improper under Rule 602.

Specifically, the defense says that Professor Fischel will testify that, A, Qwest's stock price declined when it announced its September 2000 guidance. That's a fact. If the defendant wants to establish the fact, it can do so.

He will testify most analysts did not change their recommendations, targets or forecasts after the 2000 guidance was issued. If that's the fact, the defendant can call witnesses and establish that fact. It doesn't need this testimony.

He will testify analysts did not adopt Qwest's guidance as their forecasts and instead relied on their own forecasts.

He will testify, according to the defense, analyst reports showed their understanding that economic conditions would cause Qwest's financial performance to be worse than **[2434]** expected.

He will testify, according to defense, Qwest's stock price did not decline significantly in September 2001 when it reduced the guidance.

And he will testify finally, just like Qwest, other telecommunications companies reaffirmed their guidance between September 2000 and May 2001 and reduced their guidance after May 2001.

All of those are facts. This witness has no direct personal knowledge of all of those facts. It's perfectly obvious. And the defense can establish those facts by competent evidence if it wishes to do so.

For all of those reasons, primarily the gross defect in failing to reveal the methodology, the motion to exclude the testimony of Daniel Fischel is granted.

Who is your next witness?

MR. SPEISER: Your Honor, may I be heard?

THE COURT: No. You know, in this court, we follow the rule, generally, that we have argument and ruling. Not, the Court rules, and then it's an interactive process where you get to argue later on. I have your motion, I have the Government's motion, I

have your response. Any argument that you wish to make could have been put in the response.

MR. SPEISER: We were under tremendous time pressure.

THE COURT: So what? You could have put it in the **[2435]** response. You have made your record. You have made your argument. I've ruled. This habit that the defense has of questioning every ruling by argument later on is not going to be tolerated in this court.

Mr. Stern, I'm not—sit down. I don't need to hear from you now, please.

MR. STERN: It's not on this subject.

THE COURT: Does the defense have any other witnesses?

MR. STERN: May I respond to you?

THE COURT: To that question, yes.

MR. STERN: As I understand Your Honor's ruling, we can still call Dean Fischel for summarization charts. I believe—

THE COURT: You could. If you've got summarization charts and you want to use him essentially as the Government used its summary witness, you can do that.

MR. STERN: That's the reason I stood up, not to violate any rule of this Court.

Now, we're going to need a few minutes, in light of Your Honor's ruling, to discuss this with Dean Fischel. May we have that?

THE COURT: The jury is waiting.

MR. STERN: Yes, I understand, but the defendant, it seems to me, should be given some period of time—

THE COURT: Are you telling me you haven't prepared **[2436]** these charts?

MR. STERN: I am telling—not my witness. But you told Mr. Speiser to sit down, and you're yelling at us, so I'm trying best to not offend the Court but represent a client.

THE COURT: Look, don't engage in this gratuitous self-effacing approach to things. Just answer my question.

MR. STERN: I need to speak to the witness for a few minutes. May I have a brief recess?

THE COURT: Well—and my question to you, are you telling me he's prepared charts that he can use to summarize this or not?

MR. STERN: Mr. Speiser—

MR. SPEISER: Yes, however we will need a short time to organize it.

THE COURT: Why?

MR. SPEISER: Because it was worked in the way that dealt with various opinion testimony. I'm requesting, you know, the Court give us a short recess to, you know, organize our presentation.

THE COURT: Don't you have any other witnesses?

MR. SPEISER: No.

MR. STERN: Just a minute.

Your Honor, if you don't want to give us a recess, it's—

THE COURT: Look, I want to use the jury's time. As I [2437] have told you continuously throughout this trial, when the jury is here in the jury room, I want to do my best to see that they're not twiddling their thumbs in there.

MR. STERN: Your Honor, I speak to you respectfully and in a moderate tone. I would appreciate it if you would stop shouting at me.

THE COURT: Mr. Stern, do you want to answer my question, or do you want to sit there and make speeches?

MR. STERN: I'm standing, and I'm not making a speech.

THE COURT: Sit down.

Mr. Traskos.

MR. TRASKOS: I have a request, if they were to call Mr. Fischel as a Rule 1006 witness with charts, we would have a chance to examine the underlying data. I'm not sure we're going to be able to do that in a matter of a few minutes.

THE COURT: This should have been prepared a long time ago. This couldn't have been a surprise to a lot of lawyers that I might rule this way. This is not a close question as far as I'm concerned. Maybe if you find a need to take it up to an appellate court, who knows what at appellate court would do. But as far as I'm concerned, this is not a close question. You should have been prepared. Now we're in a position where the jury is twiddling its thumbs because you haven't prepared the summary exhibits, and you need to look at the underlying—the Government has to look at the underlying documents.

[2438] MR. SPEISER: I believe we sent them all the documents.

MR. TRASKOS: Your Honor, we received last night about 8 o'clock a number of charts, but without any underlying data, including things like Michael Eisners and the other things, and it's this binder here that we printed out last night, so we have not had a fair opportunity-

THE COURT: Are those the charts that—in the binder?

MR. TRASKOS: There are a number of—this is a set of charts, public statements of Mr. Nacchio and various other things. I'm not sure which ones they're proposing to offer. They're clearly based on underlying data of some sort.

THE COURT: So you're going to need more time, if—at the—depending on—where are the charts? Show me the charts, first of all.

MR. TRASKOS: Do you want—

THE COURT: Who has got the charts?

MR. TRASKOS: I've got the binder of the demonstratives they sent last night.

MR. SPEISER: May I approach?

I believe it's tabs 2 through 6, if I could have a moment to look through.

MR. TRASKOS: I'm Sorry, which tabs?

MR. SPEISER: 2 through 6.

[2439] THE COURT: 2 through 6, he said.

MR. SPEISER: If I can have a moment, there may be some other charts we wish to—

I believe 9, 10 and 11.

THE COURT: Well, to characterize 2 through 6 as a chart stretches the word "chart" beyond any common English meaning.

MR. SPEISER: I would skip 2. I didn't mean 2, Your Honor. 3, 4, 5, 6.

THE COURT: Well, the comment applies to them too. They're not charts. And what's the next exhibit? Did you say 9, sir?

MR. SPEISER: Yes, 8, 9, 10.

3 through 10 would be the exhibits we wish to put in through the witness.

THE COURT: All right. And those were disclosed to the Government last night?

MR. TRASKOS: Yes.

THE COURT: That's the first disclosure. And it is the Government's representation that there has been no disclosure of the underlying data.

MR. TRASKOS: That's correct.

MR. SPEISER: The charts—

MR. TRASKOS: There are references, I see, of documents, but this is what we received.

[2440] THE COURT: The charts themselves—

MR. SPEISER: The charts themselves refer to what documents they're based on.

MR. TRASKOS: It seems for some of them. I'm looking at 9 right now. There is a reference to—this is what—what you have, I assume—I'm not looking at the same thing, but I assume you have the same thing that I received last night.

MR. SPEISER: Your Honor, just for the record, we received their charts from the witness yesterday, Ms. Chamberlin, we received it the night before.

MR. HEARTY: Your Honor, just to clarify, that was those two line charts that were based on the defense exhibit that went out the night before. That—that was the outliners on those two charts, just demonstrated for demonstrative purposes, and they were simply a result—graphical depiction of the defense exhibit.

THE COURT: But the remaining charts had been furnished before, according to the Government?

MR. HEARTY: That's correct.

THE COURT: And so what is it—you don't—you don't know whether these are admissible or you want to discuss them with the witness? What do you want?

MR. SPEISER: I just would like 15 minutes to be able to sit down with the witness and organize the testimony in **[2441]** light of Your Honor's ruling.

THE COURT: And then you're going to request time because they—is all of the underlying material in evidence?

MR. TRASKOS: I don't know. I have not gone through all of the materials—I didn't frankly have time, Your Honor, to go through and match up the—I wasn't focused on whichever ones there focusing. I was trying to get through all 31 of them. I don't know. Some of them may be, some of them may not be. I'd certainly like a chance to take a look at it, see if it's accurate, if it's wrong, cross-examine the witness about it.

THE COURT: Well, that seems fair. So why don't we just tell the jury to take a week off? It's now your turn, and I expect you to present a coherent organized case and to keep the thing going.

MR. STRICKLIN: Your Honor, I heard Mr. Stern say that they had no further aside from Mr. Fischel, and I just want to confirm that. Alternative would be able to call another witness.

THE COURT: That's what I was asking earlier, is whether there was another witness.

MR. SPEISER: There is not another witness.

MR. STERN: Excuse me, I didn't respond, and he knows, he just represented to you. This morning he asked you for five **[2442]** or ten minutes, it was granted. I didn't oppose it. We've asked you a simple request. You've made an important request concerning a key witness. We would like to meet with him so we can organize the testimony.

THE COURT: It was a ruling that any reasonable defense attorney would have anticipated.

MR. STERN: Well, I did not anticipate it.

THE COURT: If this was not a surprise to you, you could knock me over with a feather.

MR. STERN: I have no intention of knocking you over. But I did not anticipate the ruling, and I have made a request. It is quite customary in litigation—

THE COURT: It is not customary.

MR. STERN: 15 minutes.

THE COURT: You have 15 minutes.

MR. STERN: Thank you.

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[2454]

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MR. STRICKLIN:

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[2455]

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MR. STERN: I suggest that we take our lunch. The videos are all on exhibits that they've had for years. The man, Fischel's—

THE COURT: I'm sorry, Mr. Stern.

MR. STERN: I'll sit.

THE COURT: You're repeating what you've already said. What I've decided is—as you've all noted, we're way ahead of time. This trial is going to be completed easily within probably half the time that it was—was allotted to it.

I regret having to send the jury home, but I think

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[2462]

MR. WISE: I don't think they can get here with that tight of time.

MR. STERN: We will be sure that there is no such material used—how much notice do you need?

MR. WISE: They need to be able to get on a plane.

MR. STERN: How much notice do you need?

MR. WISE: However much time is--I'm not a travel agent.

MR. STERN: What are you asking for?

MR. WISE: A commitment, I guess.

THE COURT: I'm not here to referee this. You'll have to work out a commitment that is satisfactory to you in the form of counsel's word.

MR. WISE: Thank you, Your Honor.

THE COURT: All right. Let's get the jury.

(Jury in at 11:58 a.m.)

Members of the jury, I have some good news and some bad news.

The good news is that this trial will be over in all likelihood much earlier than any of us had anticipated. I think I told you when you were being selected that you should plan for a seven-and-a-half-week to eight-week trial. That does not look like it's going to happen. The trial will be over, in all likelihood, sometime next week and at the—at the outside, the following week.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME TWENTY-TWO

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 1:40 p.m., on the 9th day of April, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

* * *

[2578]

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THE COURT: The Court will take up two related motions.

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[2588]

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The Court has already found that neither Khemka nor Johnstone gave expert opinions. And to the extent that they did, such opinions were solicited by the defense.

Accordingly, as I said, that's the first reason that they don't need an expert to rebut Khemka's or Johnstone's testimony.

As to the proposed methodology, the Court continues to have the same difficulty with this methodology and non-disclosure of the methodology as it had with respect to the original expert report.

Any suggestion that the Government was in possession of Fischel's opinion and/or methodology is simply disingenuous. The March 29, 2007, disclosure contained no methodology or reliable application of methodology to the case.

It was precisely that lack of—lack of reliability, along with other reasons, that led the Court on April 5, 2007, to exclude much of Fischel's proposed testimony. The proposed testimony now before the Court suffers from the same problems as that which the Court has already excluded. There is no more disclosure or substantially no more disclosure than we originally had.

Further, even if it were reliable, the Court remains [2589] of the conclusion that the testimony is of no relevancy.

* * *

[2633]

All right. Any other witnesses at this time?

MR. STRICKLIN: Not presently, your Honor.

THE COURT: All right.

Members of the jury, we are—as I told you Thursday, we're moving much faster than ever anticipated, and I said that was good news and bad news. I think we've outrun our supply lines, kind of

like the third Army. It's gone so fast that we're having trouble getting the next—the logistics of the next move coordinated, so we're going to slow down just for a little bit.

I will excuse you for the rest of the afternoon.

And because I need to confer with the lawyers and because of witness logistics, we will not resume court until 1:00 p.m. tomorrow. So you're excused until 1:00 p.m.

I will reiterate for the umpteenth time my instruction not to discuss the case with anyone, your family or anyone else, or your fellow jurors, not watch or listen to or read newspaper accounts. Do not speak to any parties, attorney or witness. And keep an open mind.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME TWENTY-THREE

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 10:51 a.m., on the 10th day of April, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

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[2671]

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The Court rejects both of the dueling instructions, Defendant's Exhibit—Instruction No. 8, which really is at **[2672]** least two instructions wrapped into one, and Government's Instruction No. 9.

The Court rejects the defendant's instruction because the definition of "non-public" is unbelievably wordy and confusing. The definition of "material" is all right. And as you will see, it will be embodied in a Court instruction. The paragraph about materiality

not determined by professional securities trader is unnecessary because the Court didn't allow these so-called professional security traders to testify in this area.

The final paragraph is not confusing and there is—is confusing and unnecessary. I'll come to instructions 9 and 10 concerning forward-looking statements and the bespeaks caution doctrine in a moment. I'll just say at this point I'm not giving those instructions. I think they're wholly inappropriate for this type of insider trading case.

Similarly, I've rejected the Government's instruction because the Government's instruction defining insider is simply unbelievably wordy and expressed in legalese. The whole purpose of jury instructions is to give the jury an easy concept to deal with. The Government's instruction also duplicates a number of other instructions.

* * *

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
TRIAL TO JURY
VOLUME TWENTY-SEVEN

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 8:47 a.m., on the 12th day of April, 2007, in Courtroom A1001, United States Courthouse, Denver, Colorado.

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[3144]

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JURY INSTRUCTIONS

* * *

[3172]

"Material," in order to—for you to find a material matter or a material omission, the Government must prove beyond a reasonable doubt that the matter misstated or the matter omitted was of such

importance that it could reasonably be expected to cause a person to act or not to act with respect to the securities transaction at issue.

Information may be material even if it relates not to past events, but to forecasts and forward-looking statements, so long as a reasonable investor would consider it important in deciding to act or not to act with respect to the securities transaction at issue.

The securities fraud statute under which these charges are brought is concerned only with such material misstatements or such material omissions and does not cover minor or meaningless or unimportant matters or omissions.

So the test is whether the matter misstated or the matter omitted was of such importance that it could reasonably be expected to cause a person to act or not to act with respect to the securities transaction at issue.

With respect to each of the insider trading violations that have been charged, the Government must prove that the information allegedly possessed by the defendant at that time of his alleged trading was non-public at the time the defendant sold the security at issue.

Information is non-public if it has not been [3172] effectively disseminated to the investing public through sources such as press releases, public filings with the SEC, trade publications, analyst reports, newspapers, magazines, television, radio, word of mouth, or other sources.

To prove that the information was non-public, the Government is not required to additionally prove that Qwest was required to disclose the information at issue. A corporation has no general duty to disclose all

of its non-public or its proprietary information. Rather, you must decide whether the information at issue here was effectively disseminated to the investing public as I have defined that term in these instructions.

And finally, what does "on the basis" mean?

A person trades on the basis of inside information if the Government proves beyond a reasonable doubt that the person actually used material non-public information in deciding to trade. It is not sufficient for an insider merely to have possessed the material non-public information when he traded.

The inside—the test here is really one of cause. The inside information need not have been the sole cause of the trade. There may be other causes for the trade as well. It is sufficient that the inside information was a significant factor in an insider's decision to sell stock. A significant factor.

You will note that I have referred at several points to requirement that the defendant act knowingly and/or

* * *

2001 Product Revenue Update
4/9/01

Government Exhibit 929 05-cr-00545-EWN

* * *

CURRENT VIEW OF 2001

- $21.5B current estimate versus BOD plan of $21.8B
- 2001 revenue plan driven by sales shift to data and IP products
  - data and IP account for 60% or nearly $1.7B in year/year plan growth
- As a result base recurring revenues were planned to grow 3.5% -- 11% per quarter, 2x the rate experienced in 2000
- Current estimate indicates this shift is not occurring at the rate expected
  - annual shortfalls in private line ($125M or 6%), hosting ($111M or 40%), wireless ($156M or 15%), residential/SB local services ($157M or 3%)
  - annual gaps to be filled by IRU's, $329M or 30% higher than planned

Current Estimate Includes a Shortfall of Recurring Revenue Growth of 19%

			Growth	
	2000	**2001 CE**	**$**	**%**
Recurring	17,460.3	20,030.2	2,570.0	99%
Non-Recurring	1,493.4	1,529.8	36.4	1%
Total Revenue	18,953.6	21,560.0	2,606.4	100%

			Growth	
	2000	**2001 CE**	**$**	**%**
Recurring	17,460.3	20,639.0	3,178.7	112%
Non-Recurring	1,493.4	1,161.0	(332.4)	-12%
Total Revenue	18,953.6	21,800.0	2,346.4	100%

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Government Exhibit 959 05-cr-00545-EWN

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WHOLESALE MARKETS 2001 - 1st QUARTER REVIEW

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WHOLESALE MARKETS

Risk/Opportunity

Risk: $675M

- Market for IRUs tightening as capital spending among Carriers has slowed - $350M
- Local IRU accounting issues - $180M
- VOIP deployment schedule - $70M
- CLEC Collocation requirements softening - $50M
- UK Switch - LD impact -$25M

Opportunity:

- Work the sales funnel in conjunction with:
  - Redeployment of Collocation capital to support LD volumes
  - Reducing Network intervals on complex services
- Business to Business Deals will increase UNE platform business i.e. Mcleod, Eschelon
- Strategic Deals, i.e. Enron, C&W, MCI Worldcom

- Regulated sales compensation plan and deployment of new products
- Keep pace with market changes on leased products

* * *

Qwest Communications 04-24-01

Operator: This conference is by Qwest Communications, hosted by Lee Wolfe Conference number is 3834354. Time 89 minutes.

Good morning ladies and gentlemen and welcome to the Qwest First Quarter 2001 Earnings Release Conference Call. At this time all participants are in a listen only mode. Later we will conduct a question and answer session. I would now like to turn the call over to Mr. Lee Wolfe, Vice-President of Investor Relations. Mr. Wolfe you may begin.

Lee Wolfe: Good morning everyone. Welcome to the Qwest First Quarter Results Call. With me this morning as usual and of course is Joe Nacchio, our Chairman and CEO. But before I turn it over to Joe, I would like to remind everyone that we will be making some forward-looking statements today, which are based on the best information analysis currently available. But of course are subject to risks and uncertainties, which could cause actual results to differ materially from those we express or imply. And of course again these risks and uncertainties are on file at the FCC. Additionally we do not adopt analysts' estimates nor do we necessarily update forward-looking statements made today. With that I would like to turn it over to Joe.

Government Exhibit 593 05-cr-00545-EWN

Joseph Nacchio: Thanks Lee. Good morning everyone. We apologize for starting a few minutes late. We know there was another conference call scheduled in front of us. And for those of you who joined us from the AT&T call, I guess the best way to start would be to quote a famous English group that I am a particular fan of and use one of their best lines "And now for something completely different". With me on the call today, I would like to introduce 2 new members or really 3 new members or 3 new positions on our management team. Of course you know joining me on the call today will be my colleague and new CFO, Robin Szeliga. Afshin Mohebbi*, who you all know already, you know is now the President and Chief Operating Officer of Qwest. And just yesterday we announced joining us as Executive Vice President and President of our Wireless Group, Annette Jacobs*, who I will speak more of a little bit later. We also have on the call for the first time, although he will not be speaking, Cliff Holtz*, who joined us a week ago who will now handle our small business operations and I will be addressing that.

So we have a lot to cover this morning. I will go rather quickly. I want to cover 3 or 4 things actually in my brief opening remarks and then turn it Robin. I will provide you a brief overview of results. Robin will provide much greater detail, including what we will call our past to performance, something you have asked for as to how in a little bit more granular detail we actually achieved the growth rates. I know that has been a question people have wondered about. We are very pleased with our performance as you probably saw from our press release. We have 12 percent revenue growth our first quarter over first quarter, which I

guess from people reporting so far in the industry and what I have been watching and reading, it is 2 to 3 times the rate of anyone else in the industry. So we will provide you some granularity later in the call as to how we continue that. I will give a brief overview of operational performance of our units, again allowing you to come back on questions on that later. I want to specifically address the balance of 2001 and make some general comments on 2002. But before I begin, let me be perfectly clear, we are again affirming our targets for 2001. And to be precise the general consensus of our targets is that we will finish 2001 with revenues between $21.3 and $21.7 billion. And we will finish 2001 with EBITDA performance between $8.5 and $8.7 billion. At the end of my comments, I will speak a little bit more on 2001. But I wanted to get that up front, out of the way. Nothing you hear positively or negatively will change our view of that target which we have been holding steadfast now for the better part of a year since we announced it. I also give you some visibility into the growth rates on 2002 at the end of the call.

So let me first start with financial results. Very briefly, our revenues were up 11.8 percent. Most importantly that growth rate, sequential quarter growth rate year over year is up from 9.9 in the fourth quarter. You might remember in the fourth quarter several of you asked me, we were dipping below 10 percent on growth rates, how would we get to 15? And I noted that part of our plan there was going to be an inflection point reflecting the divestiture of our 271 revenues in the fourteenth state as a result of the US West Acquisition. And I think as you see as the call goes on you will see we have made that inflection point.

We are now accelerating our growth rates quarter over quarter, on our way to the 15 percent growth rate that we believe we achieve over our 5-year plan. Our data and IP revenues grew 45 percent, now represent 25 percent of our total revenues. And that 45 percent again is an acceleration of the 40 percent growth rate we reported in the fourth quarter and again in line with what that inflection point, which we spoke of. Similarly commercial revenues were up 26 percent. Again an inflection point greater than the 19 percent reported in the fourth quarter and EBITDA was up to almost 16 percent when you look at year over year growth rates. So we are approaching now the high teens on our way toward the 20 percent EBITDA targets we have set at the time we made the acquisition over for U S West in July of '99. So we are very pleased, I am very pleased with the performance of the management team. I know as I have been reading other notes about other companies and occasionally listening to some calls, everybody is laying everything on the economy. You know the economy made us do it, the economy made us miss our numbers. Yes there are some adjustments going on in the economy, but just for the record we are net shares of takers, of course most of our product lines. And we believe that it may be a little harder, we may have to work a little harder, but we will meet our numbers. And I think that is what we get paid to do. So I am very pleased the management team responded, worked their way through the inflection points as we had seen the 5-year plan and will add some granularity. The other thing I will say about financials for 2001, Robin will add again later, is that we are at this moment and time lowering our Cap X projections for 2001 from 9.5 to 9.2. Many of you have asked me about

Cap X in the past. I told you we are going to manage that diligently. Let me a make a key point about this $300 million reduction. First and most importantly we are not reducing it for any factors relating to demand in any of our product lines. What we have been able to take advantage of is what I believe is an extraordinary favorable pricing environment from our suppliers, all of whom are scrabbling essentially for every dollar they can get. It has become a buyers market and we are taking advantage of that fact. We are also importantly looking at asset efficiency and utilization, particularly as we streamline processes both in Classic Qwest and in the new U S West operations that have joined as we bolted them together. I actually believe as we work the year through we may be able to achieve some additional savings in capital, but we will talk more about that at the end of the second quarter.

Employee productivity, you remember when we consummated the merger on July 1st, our revenue per employee was approximately $251 thousand. At the end of the first quarter it is now standing at $311 thousand, up 24 percent since we closed the merger. The flip side of that if you remember the numbers we put it out, we said that over the 18 month period starting in July 1st of 2000 going through the end of 2001, we would reduce our headcount by 11,000 employees, 1800 contractors. At the end of the first quarter we are down now 10,000 employees, 1300 contractors. 2500 of those employees came off the payroll at the end of the first quarter. So the impact of EBITDA savings, cash flow adjustments for those down reduced for us have not yet hit the income statement and we will run through the income statement for the next several quarters. We also have

a thousand to go in terms of employees, 500 to go in terms of contractors. We think we will make those numbers some time by mid year. So we have continued efficiencies that we can achieve through our synergy.

Operational results, very briefly, commercial revenues again up 26 percent versus 19. Business and wholesale up strongly. Global business up very strong lead by growth and Data IP Products, hosting professional service and DIA, DSL, Qwest cyber solutions had another good quarter. I will talk a little bit about that. Frame ATM continues to be strong. Private Line continues to be strong, particularly at the optical wavelength level and of course we continue to penetrate both state and local and federal government accounts. I think most of the competitive lens we had this proportionally come from the AT&T base. I would not be surprised to see their business numbers going negative at their consumer rates as we continue to penetrate and get scaled. We have contracted sales of over a billion in the first quarter. That is 1/3 more than a year ago if we look at the sales funnel, 60 to 65 percent of our sales in the global market is Data and IP. And again continued strong performance and as we mentioned at the beginning of the year when we reported fourth quarter, we were adding to those sales and distribution channels. As we like to say, "Feeding the ducks while they are quacking." QCS, Qwest Cyber Solutions, strong quarter, moving up into big enterprise sales. Customers continue to preserve capital, look to outsource applications. Several big customer wins were announced this quarter. Wholesale markets very strong, particularly as we move up in to the optical wavelength area. Wave products are basically defining the market. We

continue to win the line share of the market Major sales this past quarter with the several Global IXEs. We are opening the local markets. As you know we customized deals as we did with Exxon and McCloud*, we also have Uni platforms opening. I will talk a little bit about 271. But a strong quarter for our wholesale business. If you look at our commercial markets, business and wholesale together, we believe we are sitting on about $35 to $40 million of backlog right now. Meaning if we could install quicker, get access quicker, we have actually got sold sales in the funnel. And again that is $35 to $40 million per month of revenues. I think Robin will reflect on what we think the contracted value of those sales are already.

Consumer and small business grew 6 percent, if you exclude our out of region long distance. If you include it, I believe it is 2.2 percent. I am sorry 2.7 percent. Just for the record we are not pleased with the performance of that unit. There have been management changes as you know on the Qwest side. We now have 2 Senior Executives where we had 1. Cliff Holtz* joined us to do small business. Jim Smith* moved from our Yellow Page operation, our Decks operation to run consumer. We think there is enormous upside here. That market was not covered. There was not the depth of analysis that we believe competitive firms should have in terms of understanding their markets. So we look for upside on consumer. The good news, while there are ways to improve, good things are occurring, 28 percent of our consumers now have bundles. That is up 40 percent over a year ago. We need to penetrate bundles more effectively in the business, small business market where we think we have enormous up selling

opportunities. We are pleased with the progress of bundles, but we can get better performance out of consumer and small business and that is the reason for the new executive changes. We are reorganizing small business as I said with Cliff joining us. Our priorities will be to increase sales effectiveness and focus more on strategic products and bundles.

Wireless achieved a total of $913 thousand subs is our now total. That is despite a plan $30 thousand prepaid disconnects. We are moving out of the low value consumer space. But we had the strongest quarter in terms of gross ads, but with the cleaning up of the base we need to do better to meet the rest of the year. We need to insure that these, our wireless franchise is used as a bundle play. 7 national networks in a high capitalization commodity fight on pricing is not where we are going to be. We are moving this into a pure bundle play for consumer and small business. We have made changes in that unit. Annette joins us today. We are very comfortable and confident that we will meet our yearly targets as the year goes on.

DSL has been particularly strong for us, 125 percent growth in the first quarter. We have expanded the 74 markets now. And Shawn Gillmore* and his Product Team have made great progress in getting our infrastructure ready. And we will see more acceleration as the year goes on. I also want to say I remain very positive on our testing and the learnings we are having on our VDSL trials. We look forward to being able to (Inaudible) that product probably early next year. We still have some technology developments that need to be delivered to us this summer. Our operation forces need to be able to scale

their workforce as we get capitalized labor rates down. We are looking forward to the opportunity to provide video on our services and attacking the cable monopolies that operate in our regions.

Gross margin, we will talk about a little bit more with the specific numbers. Robin will talk about that. Basically I will just say that they are inline with our investments for new products. We will get more scale economics on new products as we grow those new products in terms of market share. And we think gross margins will stabilize at about the level that we just reported for the balance of the year. Robin will talk more.

Let's talk a little bit about 2001 and why I reconfirm the estimates. In the face of I guess several of the larger players yesterday and this morning appointing to the economy for their less than targeted performance. And I have really 4 reasons why I am confident that I can do this at this time. First I have just finished 3 weeks of detailed operational reviews in every operation inside of Qwest. And we call it the Stump the Stars Meetings. And I have pretty good visibility and it goes without saying that we have challenges and my management team needs to continue to grow at a rate multiples of where our peers are as we take share. But I have confidence they can achieve it. Second, if we look at key products on the revenue side and key value drivers on the EBITDA side, we are hitting on several of them, but we have room to improve in several. For example as I said a moment ago, on the revenue side, I think we will get better performance out of small business and consumer with the new and more in-depth senior executive attention

to that market. DSL I think we will continue to improve on and grow and that will poke additional revenue to our bundles. Our bundles in general have not been as effective on small business as we have been on consumer. We have a long way to go. I am looking to Annette and Cliff specifically to accelerate that effort and region. And optical services we can penetrate we believe the commercial market on the business side, not just the wholesale side more effectively. We have great margins on our optical services and we have the leading edge industry product (Inaudible)... The second reason is we are hitting on key revenue and EBITDA drivers. Third is our region economics remain stronger than the rest of the economy despite the fact I am sure the entire economy including our region is feeling some softness. We are holding up (Inaudible) when we look at the variety of Bureau of Labor Statistic data that comes out whether you are looking at unemployment claims, housing starts, new business formations. We have some slow down. We can see that in those statistics in the first quarter, but not the material side that it effects our growth in business access lines, second lines, advance features and/or bundles. To make that point just comparison you will see in our attachment, we see our business access lines in the region growing at about 5.5 percent. Consumer slightly negative at this time, overall about 1.3. I only compared that to what I read for BellSouth in terms of what they published where I think their business was 1.7, their overall was .1. So the Southeast always tends to be a strong region. We are considerably stronger. If you look at voice grade equivalents, we are looking at voice grade equivalent lines growing to 24 percent. And that

by the way is completely consistent with our strategy of driving more local loops to broadband. So when I look at those underlying dynamics, I feel comfortable that with interest cuts, potentially the tax cut, we will see the economy strengthen in the second half. We have good momentum going through the first half and therefore I think I can hold the numbers. And then finally and I think is no small matter, I think we have a management team that I am very proud of that continues to execute and innovate. We wear our "No Wining" buttons around here. You know when something goes wrong; you come up with something new. That is what we get paid for. So if one product is not as good, you go pump another product, you change your sales compensation, you change your distribution strategies and you do it rather quickly. And so I think this is a world class team. I know many of you have doubted we would make our quarters at least for the last 16 since we have been a public company. But we have made 16. We will continue to operate the way we have. And I feel good about 2001.

Let me talk a little bit about 2002. 2002 is going to be even a better year for us and let me lay out some of the reasons. We have not fully worked all the numbers, but we clearly moving towards that 15 percent revenue growth and again high teens to twenty EBITDA growths that we targeted in terms of the 5-year plan. Let me give you one little example – 271, I am very positive about the activities that our people both in operations and regulatory are doing with 271. We are now to the point where we were doing operational systems testing across the region. We got about 70 percent of the workshops complete. If you look at service results, our service results now across the

region are the best they have been in 5 to 7 years, depending if you are measuring business versus consumer. If you look at the FCC Honors Reports that just came out, we now rate I think number 2 and number 3 in important categories of installation and repair. And we have only managed this company for 10 months. We have already accelerated to a midpoint to the upper end of the region. And make no mistake it is being noticed by our regulators. We are having our regulators even being publicly quoted in the press saying they have seen the difference and they are pleased. I think we are going to get our first 271 application filed late summer, probably August, the balance by the end of the year. First state is in, I am hoping by the end of the year all of them in first quarter. Now let me talk about what that means. We built the 5-year business plan that was very conservative on how well we performed on 271. We said in the first full year we would expect to get about $350 million of revenue as a result of LD. If we look at the experience of SBC and Verizon and their 2 states, they are taking 20 percent in those states in the first year. Some of us know a little bit about the long distance business. Cliff used to run it for me on the business market at AT&T. I bet we do as well as the RBOCs. Our regional business market for long distance is about $10 billion. If we were to do 20 percent the first year that would be $2 billion, even if you say well that is a midpoint, it is only $1 billion. It is still about 3 times what we built in our business plan. So for us 271 is the pivot point for 2002. All guns blazing, yes, we have AT&T and others whining in every jurisdiction trying to throw sand in the gear. But at the end of the day people are not fooled by that

behavior. And we will get those applications filed. The infrastructure, the second reason I am comfortable is that the infrastructure and capital programs that we are spending in 2001 will build the service capabilities for 2002 where we should see significant acceleration and revenue performance. I am specifically talking about our out of region CLEC/ELEC* businesses, which we believe next year could generate $400 million plus in revenues. Up from marginal amounts of revenue this year as we are building the infrastructure. Hosting on the centers will be complete. Of course DSL and wireless infrastructure will continue to expand. And we will have an improved focus on consumer and small business with much more powerful bundles when LV is included in basic telephony calling. And finally I think if we look at 2002 interest rate cuts, tax cuts, I believe we are going to have a stronger economy. So if we can do well this year as we are doing, we will do even better next year.

* * *

Robin Szeliga:

* * *

and depreciation that I mentioned earlier. And we expect to feel a little of pressure on EPS for the second quarter due to our increased debt following our BellSouth repurchase as well as our accelerated commercial paper refinancing. We will finalize guidance I think on the balance of the year after we get done with our purchase accounting finalization in the second quarter.

Now we have strong momentum coming out of the quarter and we have recently done as Joe noted a

pretty in depth 2001 review and still confidant in our guidance. There are a number of key elements to our success and I believe many of our performance indicators are pointed in the right direction. So let me just walk through a couple of those to give you some (Inaudible). We have seen continued sales productivity increases across all of our major channels as well as growth in our quota baring reps. We are leveraging consumer and small business inbound service reps nicely to boost our sales of our bundled offerings. Our product launches particularly in small business are seeing a great deal of success. We saw some great success on our (Inaudible) in the first quarter. Of note talking about the backlog, Joe was referring to the per month out of region backlog of 35 to 40 million. But what I think is particularly good for us is that we have multi year contract value backlog of over $500 million for our design services. I think that is terrific indication of our ability to execute on our plan. From a product perspective we also saw very strong demand on our higher speed services. (Inaudible) above service orders have more than doubled in the first quarter. We have had a fair amount of hosting capacity come on recently and we are seeing our hosting customer billings increase over 60 percent over the past year. Now if I try to frame all of those up and go to major drivers for growth in the second through the fourth quarters of this year, it looks about like our broadband service offerings and hosting including our professional services, direct internet access storage, ASP, etc... are going to grow $550 to $600 million Q2 through Q4. With our data services offering including our optical bandwidth as well as (Inaudible) ATM will generate about $750 to $800 million of growth. Looking at

wireless, I think we will see another $300 to $350 million of growth. And all our other services such as voice, directory and I include the offset of our decline in our switch accessed revenues here should generate another $3 to $350 million for the rest of the year. Giving these strong performance indicators across the key drivers and our productivity improvements, we are reiterating our guidance for 2001 as Joe said. We will see $21.3 to $21.7 billion and expect our 2001 second quarter revenue growth of something between 12 and 13 percent consistent with our planned quarterly revenue growth acceleration. So the rates will continue to accelerate off the first quarter. I think that pretty well summarizes our financial results and I will turn it back over to Lee for Q&A.

Lee Wolfe: Thanks Robin. Christine if you could give us the instructions for the Q&A session.

Christine: Thank you. We will now begin the question and answer session. If you have a question, you will need to press the one on your touch-tone phone. You will hear an acknowledgement that you have been placed in queue. If your question has been answered and you wish to be removed from the queue, please press the pound sign. Your questions

* * *

Joseph Nacchio:

* * *

drops several hundred million more. But we will give greater guidance on that as we get later in to the year.

Lynette Donovan*: And my real question is for the consumer and small business segment. I think back in

January you had indicated that your goals would grow that revenue line about 8 to 9 percent for the full year. Given that growth was a (Inaudible) quarter, I am just curious on, can you elaborate is that still your goal or?

(Cross talk)

Lynette Donovan*: How do you back end the second half of the year in that segment.

Joseph Nacchio: Let me just be clear. If we exclude and I think what we are... Just for clarification, if exclude out of region long distance on the consumer side, which we are basically in a harvest strategy, the growth was 6.3 in our franchise territory. We are going to get it closer to 8. But the real answer to you Lynette is that it was not working as it should. We made management changes at the top. We brought some new people in both on the consumer and small side where we split it. We are going to make our revenue numbers for the year. They can accelerate. To be fair I need to give Jim and Cliff a little bit more time. Although Jim has started showing improving results. We saw them in March already. And we will see as the year goes on where it goes and that. But I think we are going to be talking somewhere between 6 and 8 percent (Inaudible).

Lynette Donovan*: And now with long distance entry in that number right?

Joseph Nacchio: Oh no long distance entry in that number, none.

Lynette Donovan*: Great. Thanks.

Lee Wolfe: Next question please.

Christine: We have Anna-Maria Kovak* from Jamie Montgomery Scott online with a question, please state your question.

Anna-Maria Kovak*: First of all on recip comp...

Joseph Nacchio: Anna-Maria could you say it a little louder please?

Anna-Maria Kayak*: Yes. On recip comp, what are you looking for in terms of benefit I guess on the ILEC side from the new rule?

Joseph Nacchio: Recip comp compared to what we anticipated?

Anna-Maria Kovak*: Yes in terms of paying out.

* * *

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

1. JOSEPH P. NACCHIO,

Defendant.

UNITED STATES' MOTION TO EXCLUDE TESTIMONY BY DANIEL FISCHEL

The United States moves to exclude the testimony of Professor Daniel Fischel.

INTRODUCTION

Defendant provided its revised expert disclosure regarding Professor Daniel Fischel on Thursday, March 29, 2007. *See* Exhibit 1. Based on that disclosure, Professor Fischel should be excluded as an expert witness, for several reasons.

First, Defendant still has not complied with the expert disclosure rules. Despite the breadth of Defendant's prior disclosure on March 16, 2007, which appeared to be an attempt by Defendant to keep Professor Fischel's options open, Defendant now attempts to slip in several opinions that do not even fall within the broad topics of that prior disclosure. And while Defendant has now provided a long list of Professor Fischel's opinions, he has failed—despite's the Court's clear warning—to set forth the "reasons" and "bases" for the opinions, as required. *See* Fed. R. Crim. P. 16(b)(1)(C).

Second, Defendant has not shown that Professor Fischel's testimony is admissible. The vast majority of Professor Fischel's opinions are simply comments on the evidence—comments that are well within the jury's understanding and would not assist the jury. *See* Fed. R. Evid. 702. Although Professor Fischel is a well-known law professor who has familiarity with economics in general, there is no showing that he is qualified to serve as an economic expert as to the particular matters on which Defendant wishes to have him offer opinions in this case. *See* Fed. R. Evid. 702. The disclosure also does not show that Professor Fischel used a reliable methodology in reaching his opinions. The disclosure is essentially a list of facts and conclusions—with nothing in between. There is no suggestion that Professor Fischel actually selected any reliable principles and applied them reliably to the facts, as he must. *See* Fed. R. Evid. 702(2), (3). And in many instances, the facts from which these conclusions are drawn are not even close to the ones that an expert in the relevant field would actually rely upon. *See* Fed. R. Evid. 702 (1), 703. What is plain from this disclosure is that Professor Fischel is going to be called to testify not to provide "expert opinions" but to present and emphasize *facts*—which he is not competent to do because the facts are not within his personal knowledge. *See* Fed. R. Evid. 602.

Third, several of the facts and conclusions that Professor Fischel sets forth are entirely irrelevant. *See* Fed. R. Evid. 401, 402. Most of these "opinions" pose a significant danger of confusing or misleading the jury, or wasting their time and causing needless delay. *See* Fed. R. Evid. 403.

This brief proceeds as follows. First, it sets forth the relevant standards under Federal Rule of Civil Procedure 16 and Federal Rules of Evidence 401, 403, 602, 702, and 703, and discusses the particular case law that is most applicable here. Second, it discusses Professor Fischel's qualifications as set forth in the disclosure and on his curriculum vitae. Third, it proceeds opinion by opinion through Defendant's latest disclosure. Fourth, it explains why exclusion is warranted. A table of contents is provided on the following page.

* * *

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March 29, 2007

VIA EMAIL AND HAND DELIVERY

Cliff Stricklin
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1225 17th Street, Suite 700
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Re: United States v. Joseph P. Nacchio
Criminal Case No. 05-cr-00545-EWN

Dear Cliff:

Pursuant to the Court's order last week and in accordance with Fed. R. Crim. P. 16(b)(91)(C), the following is the summary of Professor Fischel's proposed expert testimony.

I. Qualifications

1. Daniel R. Fischel is President of Lexecon, a consulting firm that specializes in the application of economics to a variety of legal and regulatory issues. He is also Professor of Law and Business at Northwestern University School of Law and Kellogg School of Management and the Lee and Brena Freeman Professor of Law and Business Emeritus at The University of Chicago Law School. He has served previously as Dean of The University of Chicago Law

School, as Director of the Law and Economics Program at The University of Chicago Law School, and as Professor of Law and Business at The University of Chicago Graduate School of Business.

2. Professor Fischel's research and teaching have concerned the economics of corporate law and financial markets. He has published approximately fifty articles in leading legal and economics journals on various issues relating primarily to the economics and regulation of financial markets. He is coauthor, with Judge Frank Easterbrook of the Seventh Circuit Court of Appeals, of the book *The Economic Structure of Corporate Law* (Harvard University Press). Courts of all levels, including the Supreme Court of the United States, have cited his articles as authoritative. *See, e.g., Central Bank v.* First *Interstate Bank*, 114 S. Ct. 1439 (1994); *Basic Inc. v. Levinson*, 485 U.S. 224, 246 n. 24 (1988); and *Edgar v. MITE Corp.*, 457 U.S. 624, 643 (1982). His curriculum vitae, which contains a list of his publications, is attached hereto as Exhibit A.

3. Professor Fischel has served as a consultant or adviser on economic issues to, among others, the United States Department of Justice, the United States Securities and Exchange Commission, The National Association of Securities Dealers, the New York Stock Exchange, the Chicago Board of Trade, the United States Department of Labor, the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, and the Federal Trade Commission.

4. Professor Fischel is a member of the American Economics Association and the American Finance Association. He is also a former member of the Board of Directors of the Center for the Study of the Economy and the State at The University of

Chicago, and former Chairman of the American Association of Law Schools' Section on Law and Economics. He has testified as an expert witness in multiple proceedings in federal and state courts across the country, as detailed on his curriculum vitae. His testimony has concerned a wide variety of financial issues including patterns of trading by insiders, the economics of diversification, the relationship between company disclosures and the total mix of information available to investors, materiality, and the determinants of stock prices. He has also testified as an expert on multiple occasions on behalf of the U.S. Department of Justice regarding various financial issues.

II. Summary of Opinions and Bases for Opinions

5. Professor Fischel is expected to testify about Mr. Nacchio's holdings of and transactions in Growth Shares, Qwest options, and Qwest stock. In particular, Professor Fischel is expected to testify that the economic evidence is not consistent with the Government's allegation that Mr. Nacchio's stock sales during the first two quarters of 2001 ("the Questioned Sales") were made on the basis of material nonpublic information. Professor Fischel's conclusion is based on the results of his study of the Questioned Sales in relation to various benchmarks and other relevant criteria including: (i) a comparison of the magnitude and timing of the Questioned Sales with the magnitude and timing of Mr. Nacchio's sales in prior periods; (ii) a comparison of the magnitude and timing of the Questioned Sales with public statements by Mr. Nacchio and requests made by the Qwest Board as to how and when sales should occur; (iii) the relationship

between the magnitude of the Questioned Sales and Mr. Nacchio's saleable holdings; (iv) a comparison of the Questioned Sales with other contemporaneous stock transactions by Qwest; (v) an analysis of whether the Growth Share Payment created any incentive to trade on the basis of inside information; (vi) stock sales by other Qwest insiders in the period in which the Questioned Sales occurred; and (vii) stock sales by senior executives of other companies in the period which Mr. Nacchio's sales occurred. Professor Fischel is expected to testify that:

A. Mr. Nacchio's option exercises/stock sales during the first two quarters of 2001 are consistent with his pattern of option exercises/stock sales during 1998, 1999 and 2000. These data show that in each quarter from the third quarter of 1998 through the second quarter of 2001, Mr. Nacchio exercised options that had been granted to him in June 1997 and sold the shares he obtained from exercise. Moreover, in certain quarters prior to 2001, Mr. Nacchio exercised and sold a larger percentage of his exercisable holdings than he sold during the first two quarters of 2001. These data contradict the Government's claim that Mr. Nacchio's "stock sales accelerated in January 2001...."

B. The Questioned Sales are consistent with Mr. Nacchio's stated preference for receiving the January 2, 2001 Growth Share Payment in cash, because by selling the shares he received in settlement of the Growth Share Payment, Mr. Nacchio converted those shares into cash. Moreover, because the dollar value of the shares that Mr. Nacchio would receive in settlement of

the Growth Share Payment did not depend on Qwest's stock price, the Growth Share Payment did not provide Mr. Nacchio with any incentive to not disclose material inside information or sell the shares he received in settlement of the Growth Share Payment on the basis of material inside information.

C. The Questioned Sales are consistent with Mr. Nacchio's public statement at an investment community conference call on October 31, 2000 that he would be selling "about a million" shares per quarter obtained from the exercise of options granted to him in 1997 and Qwest Board's request that Mr. Nacchio avoid bunching sales during and at the end of the exercise period of the 1997 options.

D. Mr. Nacchio retained substantial saleable holdings that he would have had an incentive to sell if he were trading on the basis of material adverse inside information. In particular, at the beginning of 2001, Mr. Nacchio held Qwest stock directly and indirectly which he had obtained by exercising options and converting growth shares in prior years, but did not sell any of these shares during the first two quarters of 2001. In addition, Mr. Nacchio did not exercise any of the options he was granted in 1999, and Mr. Nacchio retained most of his vested options he held as a result of the 1997 grant.

E. Qwest's Board approved the repurchase of approximately 22.22 million shares of Qwest stock from BellSouth for $45 per share on January 15, 2001 following a discussion "led" by Mr. Nacchio, and concluded that the "repurchase

would be in the Corporation's best interest, and in the best interests of its stockholders." The repurchase is inconsistent with the claim that Mr. Nacchio (and other members of the Board) possessed material adverse inside information at this time. Mr. Nacchio and other members of Qwest's board had no incentive for Qwest to repurchase its own shares at inflated prices because they would be inflicting losses on themselves and all other Qwest shareholders by doing so.

F. The 10b5-1 sales program Mr. Nacchio entered into on February 16, 2001 (the "First 10b5-1 Program") provided for the sale of only 11,500 shares per day. Mr. Nacchio would have had an incentive to sell more shares per day if he were trading on the basis of material adverse inside information.

G. Mr. Nacchio terminated the First 10b5-1 Program on March 2, 2001 thereby reducing the number of shares sold per day from 11,500 to zero. Mr. Nacchio would have had an incentive to continue selling pursuant to the program if he were trading on the basis of material adverse inside information.

H. The 10b5-1 sales program Mr. Nacchio entered into on May 16, 2001 (the "Second 10b5-1 Program") provided for the sale of only 10,000 shares per day and only allowed sales if the price of Qwest stock was at least $38. Mr. Nacchio would have had an incentive to sell more shares per day without a floor if he were trading on the basis of material adverse inside information.

I. The Questioned Sales are consistent with the economics of diversification because Mr. Nacchio's investment portfolio was not diversified. Under these circumstances, Mr. Nacchio would have had an incentive to sell Qwest stock even if he believed that the value of Qwest stock exceeded the market price because selling Qwest stock reduced portfolio risk.

J. Many officers, directors, and employees of Qwest sold Qwest stock during the period when the Questioned Sales occurred, and in many cases, these sales constituted a larger percentage of saleable holdings than the Questioned Sales.

K. Senior officers of Qwest and other public companies (including, for example, Michael Dell, Michael Eisner, Bill Gates, Ted Turner and Sandy Weill) frequently exercised options and sold substantial amounts of stock during the period from 1998 to 2001 (when Mr. Nacchio was selling Qwest stock).

6. Professor Fischel is expected to testify about the guidance Qwest provided during 2000 and 2001 in relation to its subsequent performance as well as the effect, if any, of Qwest's guidance on Qwest's stock price as well as analysts' recommendations, forecasts and target prices. Professor Fischel will testify that Qwest's performance during the first two quarters of 2001 (i.e., the period in which the Questioned Sales occurred) was consistent with the guidance. He is also expected to testify that Qwest's failure to meet its guidance during the second half of 2001 does not demonstrate that Qwest's September 7, 2000 guidance (or Mr. Nacchio's subsequent

reaffirmations of the guidance) was incorrect, but rather reflects the massive economic downturn in the telecommunications industry. Professor Fischel's conclusions are based on: (i) a comparison of the Qwest's September 7, 2000 guidance with Qwest's actual performance during 2000 and 2001; (ii) analysis of the investment community's reaction to Qwest's September 7, 2000 guidance; (iii) a comparison of Qwest's guidance history during 2000 and 2001 with the guidance history of other telecommunications firms.[1] More specifically, Professor Fischel is expected to testify that:

A. Qwest's stock price declined when it announced its guidance on September 7, 2000.

B. Most analysts did not change their recommendations, target prices or forecasts after Qwest announced its guidance on September 7, 2000.

C. Analysts had their own forecasts, and did not adopt Qwest's guidance as their forecast.

D. Analysts' reports reflected an understanding that economic conditions could cause Qwest's

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[1] Professor Fischel has included the following telecommunications companies in his analysis: ALLTEL Corp, AT&T Corp, BellSouth Corp, Broadwing Inc, CenturyTel Inc, Citizens Communications Co, Covista Communications Inc, Genuity Inc, Global Crossing Ltd, ITC DeltaCom Inc, Level 3 Communications Inc, Primus Telecom Group Inc, RSL Communications Ltd, SBC Communications Inc, Sprint Corp, Star Telecommunications Inc, Talk America Holdings Inc, Touch America Holdings Inc, Tycom Ltd, Verizon Communications, Vialog Corp, Williams Communications, WorldCom Inc, and 360Networks Inc.

financial performance to be worse than expected.

E. Qwest's stock price did not decline significantly when it reduced its guidance on September 10, 2001.

F. Many other telecommunications companies provided guidance to the investment community during 2000 and 2001 and reaffirmed previous guidance between December 2000 and May 2001. Moreover, due to adverse changes in economic conditions, many telecommunications companies including Qwest reduced their guidance after May 2001. Furthermore, many officers and directors of telecommunications companies sold company stock after guidance which ultimately turned out to be wrong had been provided to the investment community.

7. Professor Fischel is expected to testify that the economic evidence does not establish that information concerning the magnitude of Qwest's IRU revenue would have been material to reasonable investors on the dates of the Questioned Sales. This opinion is based on Professor Fischel's analysis of: (i) the economics of recurring and non-recurring revenues; (ii) the profitability of IRU transactions; (iii) Qwest's projected future sales of IRUs; (iv) the market valuations of telecommunications companies that engaged in IRU transactions as compared to the market valuations of telecommunications companies that did not; (v) the disclosure practices of other telecommunications companies that sold IRUs; and (vi) the pattern of sales by insiders of other telecommunications companies that sold IRUs. In particular, Professor Fischel is expected to testify that:

A. The value of any firm is equal to the present value of the expected future cash flows from the operations of the firm. Therefore, the value of any particular revenue source depends on both the cost of generating the revenues, and the likelihood of future revenues. Transactions that result in revenues in the current period only may be more valuable than transactions that result in "recurring" revenues in many periods depending on profit margins, and the projected ability of the firm to engage in similar "non-recurring revenue" transactions in future periods.

B. Qwest's IRU transactions were much more profitable than its "recurring" revenue transactions as many analysts stated.

C. During the period of the Questioned Sales, Qwest projected that it would continue to sell IRUs in future periods.

D. During the period of the Questioned Sales, the revenue multiples of telecommunications companies that sold IRUs generally exceeded the revenue multiples of telecommunications companies that did not.

E. Several telecommunications companies that sold IRUs did not disclose the magnitude of their IRU sales.

F. Several reporting persons of these telecommunications companies sold stock during the period in which the Questioned Sales occurred.

8. In connection with his work in this matter, Professor Fischel and his staff at Lexecon have reviewed:

A. Stock market data for Qwest, other telecommunications firms, telecommunications industry indices, and market indices;

B. Data concerning analysts' earnings forecasts for Qwest and other telecommunications firms;

C. SEC filings and press releases made by Qwest and other telecommunications companies;

D. Filings on SEC Forms 3, 4, 5, and 144 made by officers and directors of Qwest and other telecommunications companies;

E. Press releases and financial press reports concerning guidance made by Qwest and other telecommunications companies;

F. Grant Detail, Grant Lapsed and Stock Option Exercised Reports produced by Qwest detailing employee stock option exercises;

G. Data concerning executive option exercises and stock sales obtained from ExecuComp and Thompson Financial (compiled from SEC filings);

H. Mr. Nacchio's brokerage statements;

I. Financial press articles and analysts' reports concerning executive stock sales;

J. Transcripts of Qwest's investment community conference calls;

K. Documents bates-stamped QDSECAM0439446[2], QDSEC S28764[3], QUSA0036081-87[4], QDSEC

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[2] Anshutz Trading Activity.

S27859-995[5], and QDSECAM0435641-42 & QILL 0006278731- 32[6];

L. Analysts' reports concerning Qwest and other telecommunications companies;

M. Trial testimony; and

N. Trial exhibits.

Very truly yours,

s/John M. Richilano
John M. Richilano

cc: Herbert J. Stern, Esq.

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[3] Nacchio Ownership (as of 4/30/01).

[4] Fax from SalomonSmithBarney to Rana including January 2, 2001 Form 144 filing.

[5] Qwest documents concerning "Exercise of Non-Qualified Stock Option."

[6] Rule 10b5-1 Master Trading Plans.

DANIEL R. FISCHEL **February 2007**

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PROFESSIONAL EXPERIENCE

Professor of Law and Business, Northwestern University School of Law and Kellogg School of Management (1/1/2006 – Present)

Lee and Brena Freeman Professor of Law and Business, University of Chicago Law School (7/89 – 12/2005, emeritus as of 1/1/2006); Dean of Law School (1/99 – 2/01); Professor of Law, University of Chicago Law School (1/84 – present); Visiting Professor of Law, University of Chicago Law School (7/82 – 6/83).

Jack N. Pritzker Distinguished Visiting Professor of Law, Northwestern University School of Law (6/02 - 6/03)

Professor of Law and Business, University of Chicago Graduate School of Business (7/87 – 6/90).

Director, Law and Economics Program, University of Chicago (1/84 – 6/91).

Assistant Professor of Law, Northwestern University School of Law (6/80 – 6/81); Associate Professor of Law, Northwestern University School of Law (6/81 – 6/82); promoted to full professor in 6/82.

Attorney with Levy and Erens, Chicago, Illinois (7/79 – 6/80).

Law Clerk for Associate Justice Potter Stewart of the United States Supreme Court (1978 – 1979).

Law Clerk for Judge Thomas E. Fairchild, Chief Judge of the Seventh Circuit Court of Appeals (1977 – 1978).

CONSULTING EXPERIENCE

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AREAS OF SPECIALIZATION

Corporate Finance, Corporate Control Transactions, Corporations, Financial Institutions, Regulation of Financial Markets, Regulation of Investments, Economic Analysis of Law.

PUBLICATIONS

Payback: The Conspiracy to Destroy Michael Milken and His Financial Revolution, Harper Business (1995).

The Economic Structure of Corporate Law, Harvard University Press (1991) (with Frank H. Easterbrook).

ARTICLES

The Use of Trading Models to Estimate Aggregate Damages in Securities Fraud Litigation: An Update, Briefly... Perspectives on Legislation, Regulation, and Litigation, Vol. 10, No. 3 (National Legal Center for the Public Interest, 2006) (with David J. Ross and Michael A. Keable).

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EDUCATION

University of Chicago Law School, Chicago, Illinois; J.D. 1977, cum laude; Order of the Coif; Comment Editor, Vol. 44, University of Chicago Law Review; Approximately top 1% of the Class. Awarded Casper Platt Award for best paper written by a student of the University of Chicago Law School; awarded

Jerome N. Frank Prize for excellence in legal writing while a member of the University of Chicago Law Review, 1975 – 1977. Studied law and economics with Richard Posner and other members of the faculty.

Brown University, Providence, Rhode Island; M.A. 1974 in American History.

Cornell University, Ithaca, New York; major-American History; minor-Economics; B.A. 1972.

TESTIMONY

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Deposition of Daniel R. Fischel In Re: McKesson HBOC, Inc. Securities Litigation, in the United States District Court for the Northern District of California, No. C-99-20743-RMW (August 16, 2005).

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Deposition of Daniel R. Fischel in David T. Bard, Commissioner of Banking and Insurance for the State of Vermont, as Receiver for Ambassador Insurance Company v. Arnold Chaff, et al, in the United States District Court for the District of New Jersey, Civil Action No. 85-2441 (December 12, 2002).

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

REPLY TO UNITED STATES MOTION TO EXCLUDE TESTIMONY BY DANIEL FISCHEL

Defendant Joseph P. Nacchio, by and through undersigned counsel, respectfully submits this reply to the United State's Motion to Exclude Testimony by Daniel Fischel [Doc. No. 334]. The government filed a 62-page brief attacking Mr. Nacchio's expert disclosure and asking that Daniel Fischel be excluded from testifying as an expert in this case. [Doc. 334]. The government's arguments are without merit.

I. Defendant's Expert Disclosure Complies With Rule 16

The defendant's March 15th and 29th, 2007 expert disclosure ("Disclosure") follow both the language of Rule 16 ("describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications") and the intent behind the codification of Rule 16 (to minimize surprise, the need for continuances and provide the opponent with a fair opportunity to test the merit of the expert's testimony. *See* 1993 Adv. Comm. Notes to Fed. R. Crim. P. 16).

Specifically, the Disclosure outlines three categories of expert opinion that Professor Fischel may testify about at trial. These categories are listed in paragraphs 5, 6, and 7. For each opinion, Professor Fischel has listed the documents he studied and the analysis he conducted in reaching his opinions about each subject matter. In addition, the disclosure goes further than required and outlines the specific testimony (including factual support as outlined in the lettered paragraphs under 5, 6 and 7 of the Disclosure) that Professor Fischel will provide in support of each opinion.

A. Stock Sales and Insider Behavior

The expert disclosure adequately describes Professor Fischel's opinions about Mr. Nacchio's holding of and transactions in growth shares, Qwest options and Qwest stocks (Disclosure, p. 3), including: (1) the type of information reviewed (stock sales of Mr. Nacchio, other Qwest executives, senior executives of other companies,. p. 4, and the documents listed at p. 9, paragraph 8); (2) the type of comparison made (Mr. Nacchio's sales of Qwest stock during his employment at Qwest, Mr. Nacchio's sales versus his holdings, etc. pp. 3-4); and (3) the conclusion reached (the economic evidence is not consistent with the government's allegation that Mr. Nacchio's stock sales during the first two quarters of 2001 were made on the basis of material nonpublic information).

B. Guidance and Materiality

The expert disclosure adequately describes Professor Fischel's opinions about Qwest's 2000 and 2001 guidance, (Disclosure, p. 6), including: (1) the type of information reviewed (Qwest's September 7, 2000 guidance, analyst reaction thereto, guidance documents

of 25 named telecommunications companies and the documents listed at p. 9, paragraph 8); (2) the type of analysis performed (comparing Qwest's guidance to actual performance, analysis of investment reaction to Qwest's guidance, comparison of Qwest guidance to that of other telecommunications companies, etc., pp. 6-7); and (3) the conclusion of his analysis (the guidance Qwest provided during 2000 and 2001 in relation to its subsequent performance, the effect of Qwest's guidance on its stock price, the effect of the economic downturn in the economy in the telecommunications industry on Qwest's stock price).

C. IRU Disclosure and Materiality

The expert disclosure adequately describes Professor Fischel's opinions about the materiality of Qwest's IRU transactions in January – May, 2001, including: (1) the type of document reviewed (Disclosure, p. 9, paragraph 8); (2) the type of analysis performed (the economics of "recurring" vs. "nonrecurring revenue", the market valuations of telecommunications companies that engaged in IRU transactions as compared to the market calculations of telecommunications that did not, the patterns of sales by insiders of other telecommunications companies that sold IRUs); and (3) the conclusion of his analysis (that information concerning the magnitude of Qwest's IRU revenue would not have been material to reasonable investors at the time of Mr. Nacchio's sales).

As outlined above, the Disclosure that has been provided more than sufficiently describes Professor Fischel's opinions and the reasons for those opinions. Certainly, the information in the Disclosure provides the government with a fair opportunity to test the

merits of Professor Fischel's opinions. Thus, there is no basis to exclude his testimony under Rule 16.

II. Professor's Opinions Are Proper Under Rule 702.

The subjects on which Professor Fischel will opine are not in the general knowledge of the jurors, but are rather specialized knowledge as contemplated under Rule 702, which will assist the trier of fact to understand the evidence and to determine a fact at issue. Professor Fischel has completed extensive review of SEC filings, press releases and other financial data and applied his academic study of and professional experience in economics and the public market to formulate opinions that go well beyond "simple inference." Thus, despite the government's assertions to the contrary, his testimony is not the equivalent of a channeler of facts like that excluded in *Law c. NCAA*, 185 FRD 324, 341 (D. Kan. 1999) (Expert economist was excluded when he sought to introduce hearsay content of "random phone calls" he placed and which were not normally relied upon by expert economists.")

While the government spends much of its time discussing cross-examination questions it could subject Professor Fischel to at trial, these questions do not make the proffered opinions unreliable, irrelevant or misleading – they just make the opinions supportive of defense's theory of the case, not the government's theory.

Further, Professor Fischel's opinions are not "simply facts" under Rule 602. While the government apparently views the inclusion of the factual basis for each opinion as improper opinion testimony, these facts were included to ensure full disclosure of intended

testimony to the government even though it is more than what is required under Rule 16. Further, it is entirely proper for an expert to rely on the facts of a case in forming his opinion. *See* Fed. R. Evid. 703. And, the citations quoted in the expert report are all public filings, market reports, press releases or other business records and testimony admitted at trial. Thus, they are not the type of information at issue in *Champagne Metals. Inc. v. ken-Mac Metals, Inc.* (458 F.3d 1073, 1080 n4 (10th Cir. 2006) (Where district court found that many of expert's opinions were based solely on facts provided by party/client and that "no reasonable economist would simply accept the self-serving statements of an interested party as a fact").

III. Professor Fischel is Qualified to Give the Opinions Set Forth in the Defendant's Expert Disclosure.

The government's attempts to attack Professor Fischel's expertise is belied by his 25-page CV. Mr. Fischel's expertise in economics clearly demonstrated through his extensive professional experience as a professor of Law and Business since 1987, his numerous economic publications (*See* CV, pages 2-24), and his consultation/advisement to the New York Stock Exchange, the National Association of Securities Dealers, and the Securities and Exchange Commission. (CV, p. 25). Thus, Professor Fischel is clearly an expert not just in economics -- but in the economics of financial markets, insider behavior and the materiality of IRU sales.

IV. Conclusion

For the reasons set forth above, Mr. Nacchio respectfully requests that United State's Motion to Exclude Testimony by Daniel Fischel be denied.

Respectfully submitted this 4th day of April, 2007.

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

MOTION TO PERMIT EXPERT REBUTTAL OF, OR, ALTERNATIVELY, TO STRIKE, OPINION TESTIMONY BY WITNESSES JOHNSTONE AND KHEMKA ADDUCED BY THE GOVERNMENT IN CONTRAVENTION OF THE COURT'S PRIOR ORDER AND MEMORANDUM OF DECISION LIMITING THEIR TESTIMONY [#305]

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* * *

revenues had a lower revenue multiple, which would reflect that investors collectively, perceived them as less valuable than recurring revenues.[4]

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[4] The Court should also permit this expert testimony because it was previously proffered in Professor Fischel's expert report of March 29, 2007. *See* id. p. 7-9. On this one of the several areas of Professor Fischel's proffered testimony, we the Court to reconsider its exclusion of the testimony: (1) we believe that the presentation *on this particular point* (*id.* ¶ 7) was more than adequate to satisfy the requirements of Fed. R. Cr. P. 16(b)(1)(C); and (2) in excluding Professor Fischel's testimony on this point based on *Kumho* reliability considerations, the Court overlooked

Second, by presenting the contemporaneous views of other analysts, who reached very different opinions reached different opinions from Messrs. Johnstone and Khemka about the significance of the non-disclosure of the IRUs on the value of Qwest and its stock. This would blunt the irrelevance, prejudice, and confusion on a record that currently includes only one of the several views of the matter expressed by analysts at the time, and also help effectuate requirement that materiality be judged upon the "total mix" of publicly available information.

The materials required by Fed. R. Crm. P. 16 concerning Professor Fischel's proposed expert testimony were all provided to the government on or before Saturday afternoon, April 7, 2007.

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the requirement that, while it is not "specifically mandated" to use the normal Daubert hearing to fulfill its "gatekeeper" function, the court must have sufficient evidence to perform "the task of ensuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand," and to develop a sufficient record "in order to allow a determination of whether the district court properly applied the relevant law." *See, e.g., Goebel v. Denver and Rio Grande Western RR*, 215 F.3d 1083, 1087-88 (10th Cir. 2000). An evidentiary hearing is particularly appropriate where, as here, the court believes the experts' report was insufficiently detailed. *See U.S. v Call*, 129 F.3d 1402, 1405 (10th Cir. 1997)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

UNITED STATES' PROPOSED DISPUTED JURY INSTRUCTIONS

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* * *

United States Proposed Instruction No. 12
"MATERIAL" INFORMATION

The government must also prove that the nonpublic information allegedly possessed by the defendant was "material." Information is material if there is a substantial likelihood that the information would have been viewed by a reasonable investor as important in deciding whether to buy, sell, or hold securities, or at what price to buy or sell.[1]

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[1] *See TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (holding, in the context of a challenge to a proxy statement, that "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."); *SEC v. Chochran*, 214 F.3d 1261, 1268 (10th Cir. 2000) (concluding that "information implicating the fair market value would be material to a reasonable investor"); *United States v. Teicher*, 987 F.2d 112, 120-21 (2d Cir. 1993) (observing that an individual with inside

Information may be material even if relates not to past events but on forecasts and forward-looking statements, so long as a reasonable investor would consider the information important in deciding whether to buy, sell, or hold securities, or at what price to buy or sell.[2] In evaluating whether forecasts and forward-looking information is material, you should evaluate the importance of the information to a reasonable investor, such as the probability that the future events will or will not occur and the anticipated magnitude of the events in light of the totality of company activity.[3]

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information may alter his choices in various ways, and "it would be a misstate to think of such decisions as merely binary choices – to buy or to sell").

[2] *See Basic Inc. v. Levinson*, 485 U.S. 224, 238, 108 S. Ct. 978, 987 (1988) (holding that the possibility of a merger could be material); *United States v. Smith*, 155 F.3d 1051, 1064-66 (9th Cir. 1998) (rejecting the contention that forward looking or "soft" information cannot be material"); *see also* Transcript of March 24, 2006 hearing in *United States v. Nacchio*, 05-cr-00545-EWN, at 16-17 (discussing *Basic Inc. v. Levinson* and stating that "[t]here is an implicit recognition in [*Basic*] that materiality can be used not only on past events, but it can be based on the probability that future events will or will not occur"); *see id.* at 17-18 (explaining that *Basic, Inc.* "stands for the proposition that future events can, depending on the probability of such events and other factors peculiar to the case, be the basis for an action under Section 10(b)"); *id.* at 18-20 (stating that "the most persuasive case after *Basic Incorporated* ... is the Ninth Circuit's decision in *United States v. Smith*").

[3] *Basic Inc. v. Levinson*, 485 U.S. 224, 238, 108 S. Ct. 978, 987 (1988) (observing, in the context of preliminary merger negotiations and a proxy statement, that with respect to such forward-looking information, materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity").

The information need not be such that a reasonable investor would necessarily change his or her investment decision based on it, as long as it is substantially likely that a reasonable investor would have viewed it as significantly altering the total mix of information made available concerning the company.[4]

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[4] *Cf. TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (explaining that materiality "does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

JOSEPH P. NACCHIO'S ADDITIONAL REQUESTS TO CHARGE

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* * *

DEFENDANT'S INSTRUCTION NO. 9

ALL COUNTS – INSIDER TRADING FIRST ELEMENT: MATERIAL NON-PUBLIC INFORMATION -- FORWARD-LOOKING STATEMENTS AND "SOFT INFORMATION"

A "forward-looking" financial statement is a statement containing a projection of revenues, income, or earnings, or other financial items.[1]

Predictions of future corporate performance are inevitably inaccurate because things almost never go exactly as planned.[2] Projections which turn out to be

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[1] 17 C.F.R. § 230.175(c)(1) relating to 1933 Securities Act); 127 C.F.R. § 240.3b-6 Exchange Act).

[2] *Arazie v. Mullane*, 2 F.3d 1456, 1468 (7th Cir. 1993) (citation omitted); *Grossman v. Novell*, Inc., 120 F.3d 1112, 1119-1120 ("Statements classified as 'corporate optimism' ... are typically forward-looking statements, or are generalized statements of

inaccurate are not fraudulent simply because subsequent events reveal that a different projection would have been more reasonable.[3]

In this case, the forward-looking financial statement consisted of the September 7, 2000 projection 15 months into the future that revenues of Qwest would be between $21.3 and $21.7 billion, and each subsequent affirmation of that projection through May 29, 2001, when Mr. Nacchio stopped selling Qwest stock.

A forward-looking statement of the type conveyed to the public by Qwest and Mr. Nacchio on or about September 7, 2000, cannot be considered by you to be "material" under the law unless it is shown that the statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith[4]. Forward-looking statements need not be

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optimism that are not capable of objective verification ... [and] are not actionable because reasonable investors do not rely on them in making investment decisions," citing *Raab v. General Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993)(statements in Annual Report that company expected "10% to 30% growth rate over the next several years" and was poised to carry the growth and success of 1991 well into the future" held to be immaterial "soft 'puffing'" statements)(other citations omitted).

[3] *Grassi v. Information Resources, Inc.*, 63 F.3d 596, 599 (7th Cir. 1995); *Goss v. Summa Four, Inc.*, 93 F.3d 987994 (fraud does not result from the mere contrast between a defendant's past optimism and less favorable actual results)(1st Cir. 1996).

[4] *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1119 (10th Cir. 1997) ("Statements classified as 'corporate optimism' ... are typically forward-looking statements," which the 10th Circuit Court of Appeals indicated through citations are often held to be immaterial, even sometimes as a matter of law (citations omitted), but further noted that "[t]his is not to say that forward looking statements cannot be material" because the U.S. Supreme Court (citation omitted) "made it quite clear that a statement as to

correct; it is enough that they have a reasonable basis.[5] Similarly, statements as to beliefs or opinions, which is sometimes referred to as "soft information," can only be material if that opinion or belief is known by the speaker at the time it is expressed to be untrue or to have no basis in fact since such information, including projections and estimates, inherently involves some subjective analysis or extrapolation.[6]

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beliefs or opinions ... may be actionable if the opinion is known by the speaker at the time it is expressed to be untrue or to have no reasonable basis in fact")

[5] *Id.; Wielgos v. Commonwealth Edison Company*, 892 F.2d 509, 513 (7th Cir. 1989). *Accord Arazie v. Mullane*, 2 F.3d 1456, 1466 (7th Cir. 1993) ("If all estimates are made carefully and honestly, half will turn out too favorable to the firm and the other half too pessimistic"). *See Raab v. General Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993) ("Projections of future performance not worded as guarantees are generally not actionable under the federal securities laws".

[6] *Garcia v. Cordova*, 930 F.2d 826, 830 (" 'soft information,' that is, 'information about a particular issuer or its securities that inherently involves some subjective analysis or extrapolation, such as projections, estimates, opinions, motives, or intentions.' " (citation omitted). Court held that after careful consideration of all facts and circumstances relating to the nature of the subject information, the soft information at issue here (relating to corporate asset appraisals) was too speculative and unreliable to require disclosure under 10b-5 as 'material fact.' ")(10th Cir. 1991); See also, *SEC v. Butler*, 2005 U.S. Dist. LEXIS 7194 ("Internal projections of profits and revenues," including information available to the alleged insider trader through forecast meetings at the time he made the trades at issue, "was simply not a reliable indicator of [the company's] probable quarterly revenue, nor was it a valid indicator of its earnings," and the court found that the trader did not possess material nonpublic information when he made his trades.) (E.D.Pa. 2005) (10th Cir. 1991).

In making forward-looking statements of future revenue, Qwest and Mr. Nacchio were not required to reveal their data, assumptions, and methods.[7] Nor were they required to reveal the projections generated internally. Even if some of those internal projections conflicted with its publicly-issued projections or guidance that information would not be considered material, and Qwest and Mr. Nacchio would only be required to disclose such tentative internal projections that conflicted with the published projections if the internal figures were so certain that they show the published figures to have been without a reasonable basis.[8]

If the September 7, 2000 projections were reasonable, then after September 7, 2000, there was no duty to correct projections unless conflicting internal projections which were certain and reliable, not merely tentative estimates, made the previously public guidance materially misleading.[9]

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[7] *Wielgos*, 892 F.2d at 515.

[8] *See Wielgos*, 892 F.2d at 516 ("Any other position would mean that once the annual cycle of estimation begins, a firm must cease selling stock until it has resolved internal disputes and is ready with a new projection. Yet because large firms are eternally in the process of generating and revising estimates-they may have large staffs devoted to nothing else-a demand for revelation or delay would be equivalent to a bar on the use of projections *if the firm wants to raise new capital*").

[9] *In re Healthcare Compare Corp. Sec. Lit.*, 75 F.3d 276, 282 (7th Cir. 1996); *McDonald v. Kinder-Morgan, Inc.*, 287 F.3d 992, 998 (10th Cir. 2002) (*aff'g* Nottingham, J.) (accurate reporting of historic financial results does not give rise to a duty "to further disclose *contingencies* that might alter the revenue picture." (emphasis added).

DEFENDANT'S INSTRUCTION NO. 10
ALL COUNTS – INSIDER TRADING FIRST ELEMENT: MATERIAL, NON-PUBLIC INFORMATION – CAUTIONARY LANGUAGE ACCOMPANYING PROJECTIONS AND STATEMENTS

When reasonable forecasts, opinions, or projections in a disclosure statement are accompanied by warnings and cautionary language which provide the investing public with sufficiently specific risk disclosures, forward-looking statements cannot be material.[1]

As an example, cautionary language accompanying a projection would include a statement that forward-looking statements are attended by risks and uncertainties that could cause actual results, including financial results, to differ materially from those expressed or implied by the projections.

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[1] *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1120 (10th Cir. 1997) (cautionary statements that "future earnings and stock price could be subject to significant volatility, particularly on a quarterly basis" and "Novell's revenues and earnings may be unpredictable" and "Quarterly financial results are difficult to predict and quarterly financial results may fall short of anticipated levels" were "highly specific, very factual, and directly address[ed] the predictive statements" in question); *Id.*, ("Forward-looking representations are also considered immaterial when the defendant has provided the investing public with sufficiently specific risk disclosures or other cautionary statements concerning the subject matter of the statements at issue to nullify any potentially misleading effect."); *Id.* at 1121 ("Accordingly, we hold that the 'bespeaks caution' doctrine, as articulated in this opinion, is a valid defense to a securities fraud claim in the Tenth Circuit."); *United States v. Morris*,80 F.3d 1151, 1167 (7th Cir.) (citation omitted), *cert. denied*, 519 U.S. 868 (1996); *United States v. Morris*,80 F.3d 1151, 1167 (7th Cir.) (citation omitted), *cert. denied*, 519 U.S. 868 (1996).

Therefore, I instruct you that while forward looking statements can be "material," as I have defined the term for you, they cannot be "material" if:

(a) the forward looking statement had a reasonable basis in fact when issued[2]; and

(b) the investing public has been provided with sufficient specific risk disclosures, or other cautionary statements to nullify any potentially misleading effect.[3]

Thus, in order to find Mr. Nacchio guilty on any of the counts in the indictment you must first find that it has been proven beyond a reasonable doubt that the forward-looking projections of revenue were "material," that they had no reasonable basis in fact, and that the warnings which accompanied them were insufficient to nullify any potentially misleading effect.

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[2] *Wielgos*, 892 F.2d at 514 ("Forward looking statements need not be correct. It is enough if they have a reasonable basis"); *Grossman*, 120 F.3d at 1120 n.6 ("This is not to say that forward looking statements cannot be material ... a statement as to beliefs or opinions ... may be actionable if the opinion is known by the speaker at the time it is expressed to be untrue or to have no reasonable basis in fact") (emphasis added); *Id.* at 1120 ("Forward looking statements are also considered immaterial when the defendant has provided the investing public with sufficiently specific risk disclosures or other cautionary statements concerning the subject matter of the statements at issue to nullify any potentially misleading effect. This doctrine ... is called the 'bespeaks caution' doctrine").

[3] In *Grossman*, the Tenth Circuit specifically approved the "bespeaks caution" doctrine: "Accordingly, we hold that the 'bespeaks caution' doctrine, as articulated in this opinion, is a valid defense to a securities fraud claim in the Tenth Circuit." 120 F.3d at 1121.

If the materiality of the September 7, 2000 guidance has not been proven beyond a reasonable doubt, then you must find Mr. Nacchio not guilty. However, if you find that materiality has been proven beyond a reasonable doubt then you must also consider whether Mr. Nacchio traded on the basis of the material, non-public information.

In this case, the indictment alleges that the material, non-public information upon which basis Mr. Nacchio traded was the views of other corporate officials who, as time went by, advised him, among other things, that the publicly-issued guidance for 2001 was a "huge stretch," "aggressive," and in "jeopardy." However, so long as the publicly-issued guidance remained reasonable, any contrary views which you find to have been expressed by insiders to Mr. Nacchio would not be considered by the law to be "material" and therefore would pose no legal prohibition to anyone trading on the basis of those views.

On the other hand, if additional non-public information deprived the existing public guidance of its reasonable basis, then such non-public information would be "material" for purposes of the law if the risk disclosures or other cautionary statements were not sufficient to nullify any potentially misleading effect.[4]

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[4] *Wielgos*, 892 F.2d at 516 ("*Panter v. Marshall Field & Co.*, 646 F.2d 271, 291-93 (7th Cir. 1981), holds that firms need not disclose tentative internal estimates, even though they conflict with published estimates, unless the internal estimates are so certain that they reveal the published figures as materially misleading ... Issuers need not reveal all projections. Any firm generates a range of estimates internally or through consultants. It may reveal the projection it things best while withholding others, as long as the one revealed has a 'reasonable basis' – a question on

Simply put, tentative internal estimates need not be disclosed even though they conflict with public estimates, unless those internal estimates are so certain that they reveal that the published figures as unreasonable.

In determining whether those providing conflicting estimates were expressing material information, you should consider whether such proponents were aware of all of the facts necessary to make their opinions material, such as their awareness or lack of awareness of the full scope of all of the business prospects of Qwest, including potential government contracts.

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which other estimates may reflect without automatically depriving the published one of foundation. Because firms may withhold even completed estimates, they may withhold in-house estimates that are in the process of consideration and revision. Any other position would mean that once the annual cycle of estimation begins, a firm must cease selling stock until it has resolved internal disputes and is ready with a new projection. Yet because large firms are eternally in the process of generating and revising estimates – they may have large staffs devoted to nothing else – a demand for revelation or delay would be equivalent to a bar on the use of projections if the firm wants to raise new capital").

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

JOSEPH P. NACCHIO,

Defendant.

REPORTER'S TRANSCRIPT
SENTENCING

Proceedings before the HONORABLE EDWARD W. NOTTINGHAM, Judge, United States District Court for the District of Colorado, commencing at 9:00 a.m., on the 27th day of July, 2007, in Courtroom A201, United States Courthouse, Denver, Colorado.

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[75]

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You know, with all respect, when a choice has been made, as I alluded to before, by Mr. Nacchio himself, the choice hasn't always involved putting this young man at the very top of his list. He came to Colorado, took this job in Colorado. And as I've said, I see no reason why this man who grew up, the son of Italian immigrants, who grew up in New Jersey and New York, should ever have come out here to Colorado -- not that I think Colorado is a bad state, but his family was there. His ties were there. The son who needed him was there. The only reason I can see that he came here was, as I said before, greed. The love of money.

* * *

[91]

* * *

MR. STERN: I not only think so, I think—I professionally say to you, it is my honest best judgment.

It is one thing to determine credibility. It is another thing to say that we were not entitled to call an expert because the Rule 16 notice was not sufficient.

THE COURT: Well, that was only one of multiple bases.

* * *

[107]

* * *

Next, the defendant complains, as he did at trial, of my exclusion of his expert. He raises Rule 16 and *Daubert*.

Those were not the only—I think those were a sufficient basis, but those weren't the only bases or the main bases on which the Court rested its decision. The Court relied on Rule 702, 403 and 602.

Under Rule 702, the Court found that the expert's testimony would not be helpful to the jury, and this alone warranted exclusion. I said that because the proposed expert testimony was more akin to a closing argument. It recited facts that were not within the proposed expert's personal knowledge, some of the testimony was irrelevant, and much of it was regarding common knowledge and posed the danger of misleading jurors into believing they could not rely on their own common sense.

* * *

NO. 07-1311

IN THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

JOSEPH P. NACCHIO,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLORADO
THE HONORABLE JUDGE NOTTINGHAM
DISTRICT COURT NO. 1:05-cr-00545-EWN

APPELLANT'S OPENING BRIEF

* * *

B. The Omissions At Issue Were Not Material

1. Even in civil cases, liability can only rarely be imposed on the theory that a defendant somehow had "material" information that a *prediction* would not come true. In general, the materiality of information about contingent future events "'depend[s] at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the

totality of the company activity.'" *Basic*, 485 U.S. at 238 (citation omitted); *see also TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (requiring "a *substantial likelihood* that the disclosure of the omitted fact would have been viewed by the reasonable investor as having *significantly* altered the 'total mix' of information"). *Basic* involved undisclosed merger discussions, and the Court noted that simple "probability/magnitude" analysis might not be sufficient for "other kinds of contingent or speculative information, such as earnings forecasts or projections." 485 U.S. at 232 n.9.

In the specific context of earnings projections, many courts have drawn a hard line that "projections of *future* performance ... [are] actionable under §10(b) ... only if they are supported by specific statements of fact or are worded as guarantees." *Malone v. Microdyne Corp.*, 26 F.3d 471, 479 (4th Cir. 1994) (emphasis in original). That rule is dispositive here. But even courts that have not embraced that strict an approach have held that a projection "can lead to liability under Rule 10b-5 only if it was not made in good faith or was made without a reasonable basis." *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1333 (7th Cir. 1995); *Provenz v. Miller*, 102 F.3d 1478, 1487 (9th Cir. 1996); *Kowal v. MCI Commc'ns Corp.*, 16 F.3d 1271, 1276–77 (D.C. Cir. 1994); *Wielgos*, 892 F.2d at 513; *see also Grossman*, 120 F.3d at 1119 n.6 (suggesting that projections "may be actionable if the opinion is known by the speaker at the time it is expressed to be untrue or to have no reasonable basis in fact").

That rule has a long history in case law under Rule 10b-5, and has been restated and codified in two SEC

rules.[4] A forward-looking statement "shall be deemed not to be a fraudulent statement ... unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." 17 C.F.R. §240.3b-6(a); 17 C.F.R. §230.175(a). A "fraudulent statement" is defined to include "a statement which ... constitutes the employment of *a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud*, as those terms are used in the Securities Exchange Act of 1934 or the rules or regulations promulgated thereunder." 17 C.F.R. §240.3b-6(d). In other words, "fraudulent statement" is "shorthand for *all* the bases of liability in the ... Act and its implementing rules." *Wielgos*, 892 F.2d at 513.[5]

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[4] Rule 175 applies to the Securities Act of 1933; Rule 3b-6 applies to the Securities Exchange Act of 1934. Otherwise, the rules are identical. The rules were promulgated to "encourage companies to disclose management projections," SEC Release Nos. 33-5992, 34-15305, 43 Fed. Reg. 53,246, 53,247 (Nov. 15, 1978), and in effect restated earlier case law regarding when forward-looking statements may be deemed materially misleading. *See, e.g., Marx v. Computer Scis. Corp.*, 507 F.2d 485, 490 (9th Cir. 1974); *Isquith v. Middle S. Utils.*, 847 F.2d 186, 204 n.12 (5th Cir. 1988).

[5] Rule 3b-6 applies directly to this case, because Qwest's public projections were filed with the SEC. *See* 17 C.F.R. §240.3b-6(b)(1). Regardless, courts have broadly applied these legal standards to all cases involving forward-looking information. *See, e.g., Stransky*, 51 F.3d at 1333 & n.8 (applying reasonable basis standard even though "Rule 175, strictly speaking, is not applicable to [this] case"); *Kowal*, 16 F.3d at 1276–77 (applying reasonable basis standard without mentioning SEC rules); *Hillson Partners Ltd. P'ship v. Adage, Inc.*, 42 F.3d 204, 216-17 (4th Cir. 1994) (same).

Under the "reasonable basis" standard, data, assumptions, estimates, and other information that might cast doubt on the public projection need not be disclosed unless that information is "so certain that [it] reveal[s] the published figures as materially misleading." *Wielgos* 892 F.2d at 514–16; *Krim v. BancTexas Group, Inc.*, 989 F.2d 1435, 1449 (5th Cir. 1993) (defendant must know "to a *certainty*" that the projections are unattainable); *In re Healthcare Compare Corp. Sec. Litig.*, 75 F.3d 276, 282 (7th Cir. 1996) (estimates diverging from public projections not material omissions unless "certain and reliable"). The evidence must show that the undisclosed "problems were so widespread and severe" that the defendant knew its projection was "unattainable." *In re Apple Computer*, 127 Fed. Appx. at 300. These rules are essential: "Any other position would mean that once the annual cycle of estimation begins, a firm must cease selling stock until it has resolved internal disputes and is ready with a new projection. Yet because large firms are eternally in the process of generating and revising estimates—they may have large staffs devoted to nothing else—a demand for revelation or delay would be equivalent to a bar on the use of projections if the firm wants to raise new capital." *Wielgos*, 892 F.2d at 516. *Wielgos* involved sales by the company, but a rule that prohibited individual insiders from trading until all internal forecasts and estimates have been made public would similarly bar insiders from buying or selling company stock altogether.

Courts have applied similar principles to internal estimates or intra-quarterly operating results even when there are no published projections. In *Shaw*, for example, plaintiffs claimed that a company sold stock

eleven days before the end of a quarter without disclosing "material knowledge of facts indicating that the ... quarter would be an unexpectedly disastrous one." 82 F.3d at 1206. The First Circuit held that "soft" information in the form of internal predictions is always immaterial, *id.* at 1211 n.21, but that "[i]f ... the issuer is in possession of [hard] nonpublic information indicating that *the quarter in progress at the time of the public offering* will be an *extreme departure* from the range of results which could be anticipated based on currently available [public] information," then the company must either disclose that information or refrain from selling. *Id.* at 1210.

The claim in *Shaw* met that standard, but the Court emphasized that nondisclosure claims based on information presaging possible developments four to six months in the future have been dismissed because the omissions should be "deemed immaterial as a matter of law." *Id.* at 1211. Similarly, in *In re Worlds of Wonder*, the plaintiffs claimed that the company failed to disclose recent sales figures allegedly portending that its sales would decline precipitously six months in the future. 35 F.3d at 1418–20. Affirming dismissal, the Ninth Circuit held that this argument "distill[ed] to a contention that [the company] should have predicted the collapse in sales that occurred in late 1987, long after the [prospectus]"—a prediction the company had "no duty" to make. *Id.* at 1420.

2. As discussed below, the verdict must be reversed because *none* of these legal principles were charged to the jury. But Nacchio was entitled to a judgment of acquittal in any event, because the evidence was insufficient to support a finding, under the probability/magnitude standard of *Basic* or the

more specific rules governing projections, that Nacchio had *material* inside information.

a. *At the time of the trades, the information available to Nacchio did not reveal, to* any *degree of certainty, that Qwest would fail to meet its year-end numbers eight months in the future.*

On September 7, 2000, Qwest raised its 2001 revenue projections to a range of $21.3 billion to $21.7 billion. APP-4781. That was a modest (1.4%) increase from a $21.0 billion estimate prepared earlier by major investment banks in connection with the merger of Qwest and U.S. West. APP-1756–58, 2355. Qwest was already running ahead of those bankers' projections for 2000, and ultimately exceeded them by 2.5%. APP-1758–59, 2355, 3324–25. Nacchio believed that matching Qwest's entrepreneurial culture with U.S. West's customer base would lead to strong growth in 2001. *See* 1759–61, 2379–80 (Qwest's senior managers, including Nacchio, believed 2001 would be a "barn burner"), APP-2396 (Nacchio expected enormous U.S. government demand for fiber optic capacity). Developments between December and May did not establish that the projections had become unattainable or even improbable.

First, Qwest's internal budget process supported the year-end projections. The overall *internal* revenue target for 2001 was initially set by senior management at $22 billion—$700 million above the low end of the public projections. APP-2126–27, 2267, 2429–30. These were called "stretch" budgets, which were "aspirational and generally set higher than street numbers to encourage the employees to exceed the public values." APP-2138–39, 1918, 2373–77, 3336–37. Business units prepared plans to meet their assigned

targets. APP-2138–39, 2326. The managers had a personal incentive to depress expectations because their compensation was tied to beating their targets. APP-2369–70, 2374–77. The first 2001 budget "submissions" from the business units in October 2000 nevertheless totaled over $21.3 billion, even though they were constructed on estimates for 2000 revenues that proved to be too low. APP-4967. In February, the Board ultimately approved an *internal* budget with a 2001 revenue target of $21.8 billion—a "stretch" of just 2.3% more than the initial plans from the business units, and $500 million above the low end of the public projections. APP-2164, 4967, 4975. The budget process continued, but the combined estimates in the submissions of the business units always exceeded $21.3 billion—the low end of the public revenue projections. APP-4967. During the period of Nacchio's trades, *there was not a single internal Qwest estimate forecasting 2001 revenues below $21.3 billion.*

The government nevertheless succeeded in confusing the jury by repeatedly presenting evidence of "gaps" between the business units' proposals and their budgeted targets. But the "gaps" related only to the higher *internal* budget. For example, the indictment alleged that COO Afshin Mohebbi told Nacchio that the projections were a "huge stretch" in a December 2000 memorandum. But Mohebbi, a government witness, confirmed that the memo was only referring to the initial $22 billion *internal* budget target. APP-4990–92, 3163–64. The memo expressed the view that "recurring business" had "to literally take off by April-May" to hit $22 billion, but it also identified the steps to achieve it. APP-4990–92. Nacchio took all of them. APP-3360–61.

Second, Qwest met market expectations and nearly equaled the *internal* targets in the first and second quarters. Qwest's first-quarter revenues were only $4 million short of the internal goal of $5.055 billion. APP-4699–700, 2384. These results were realized virtually simultaneously with the April trades for which Nacchio was convicted.

In May, Qwest's performance was still strong. According to the financial summary, or "dashboard," presented to Nacchio in mid-May, the company fell just 2.3% short of its estimate for April. APP-5020. The consumer unit—a main driver of recurring revenue—came within $1 million (or 0.2%) of its estimate, APP-5022, and forecasted that it would fall just short of its third-quarter internal budget target and exceed its fourth-quarter target, APP-5095, 2924. Moreover, the wholesale markets unit—the supposed epicenter of impending disaster—beat its internal target for April, APP-5021, and the unit head, Greg Casey, told Mohebbi on May 10 that they were generating strong *recurring* sales and revenue "looked pretty good." APP-2571–72. Indeed, Qwest's second-quarter revenues ultimately met investors' expectations. APP-2381–82.

Third, on April 9, 2001, senior managers led by CFO Robin Szeliga, the government's chief witness, produced an internal "current estimate" that 2001 revenues would reach $21.56 billion—comfortably above the low end of the public projections. APP-5001. Although recurring revenue was not as strong as had been hoped, non-recurring revenue was considerably stronger. *Id.* As the CFO confirmed at trial, "as of April the 9th, *with all of the debates* ... the internal current view of Qwest was that they would reach $21.5

billion by December 31st, 2001." APP-2323; *see also* APP-3276–77 (COO Mohebbi confirming the same).

The only quantified "risk" presented to Nacchio in the April 2001 estimate was in the wholesale markets forecast, which was predicated on Greg Casey's predictions about the future of the economy.[6] Casey, head of the wholesale unit, identified $350 million of budget "risk" for the remainder of the year from a softening IRU market. APP-2496, 2545, 5037. Szeliga testified that this $350 million is what "Casey was trying to point out" when he said that "demand was lessening ... for the IRUs." APP-2228–29. The internal budget goals already expected the IRU market to decline, APP-2155–56, 2167, 5002, and Nacchio challenged Casey's prediction that the IRU market would be still weaker than forecasted, APP-2230. The hard data from first quarter 2001 gave Nacchio reasonable grounds for his view. As of April 9, "non-recurring" revenues had exceeded internal goals by $107 million, or 26%, mostly on the strength of the global business unit's IRU sales. APP-5008, 5015, 5061. After this strong quarter, the company raised its estimate for IRU revenue from the global business unit. (The entire increase in forecasted IRU revenues in the April 9 product update came from higher forecasts in this unit. APP-5008, 5010.) It also became clear after the April planning meetings that there were additional IRU opportunities which had not been forecasted or budgeted for by Qwest's managers,

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6 Because Qwest had an "unlimited supply of capacity to sell," APP-1703, Qwest's ability to sell IRUs was strictly a function of economic demand.

including a large deal with Microsoft. APP-2572–73, 2700–03.

Nacchio was not compelled to adopt Casey's opinion. Revenues at Qwest routinely materialized despite self-interested pessimism from managers. In October 2000, Casey's wholesale unit estimated a fourth-quarter target miss of $170 million, *or nearly 16%*. APP-4939. Yet the unit ultimately *exceeded* its year-end estimate by $276 million. APP-4943, 4980. Similarly, the global business unit exceeded its November current estimate for year-end 2000 by $377 million, APP-5100, 4980, despite having forecasted a fourth-quarter target *miss* of $121 million, or 8%, APP-5098. In March 2001, Nacchio was told that Qwest would need $486 million from "risky" "C" revenue initiatives to meet internal goals for the first quarter. APP-4995. *Nearly all* the initiatives materialized. *See* APP-4258. These were the type of "C" initiatives Casey had included in his 2001 target budget, and that the government contends were so "risky" Qwest should have valued them at nothing. APP-2485. These internal scenarios were repeated over and over in Qwest's history through 2001, *see, e.g.*, APP-2375–76, 3196, 3324–25, 3343–44, 3351–52, 3371–72—and yet the company met or exceeded its public numbers for seventeen straight quarters. APP-2259, 2341–42.

In sum, a reasonable jury could not find that Nacchio had information in April revealing that it was certain, or even probable, that Qwest would not reach its public projections by year end.

b. *The "magnitude" of any shortfall reasonably anticipated in April* also *was not large enough to be material.*

The centerpiece of the government's case was Casey's April 2001 prediction that wholesale IRUs were "drying up." APP-2581. Even if Qwest had eliminated those revenues from the budget *in their entirety*, the adjusted current estimate would have been only 0.4% short of the public projections. APP-5037. The "magnitude" of that shortfall would be immaterial as a matter of law under *Basic*. And the same holds true for the prosecution's (misleading) argument that there was a "billion dollars of risk" in the internal budget. *See* APP-2211. Even if the jury thought that "risk" was a *certainty*, Qwest still would have exceeded 2000 revenues by a wide margin and only missed its *public projections* by a mere 1.4%. *See* APP-2268 ("billion dollar risk" pertained to initial $22 billion budget target). A miss that small is immaterial as a matter of law. *See In re Apple Computer*, 127 Fed. Appx. at 304 ("[A] revenue estimate that was missed by approximately 10% was immaterial as a matter of law"); *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1268 (10th Cir. 2001) (dismissing complaint where contingency threatened only 2.4%–3.5% of company's assets and 10% of company's net worth); *Shaw*, 82 F.3d at 1210 (shortfall must represent an "extreme departure from the [expected] range of results").

Of course, those calculations greatly overstate the risks. Companies are not allowed to deliberately err on the side of caution by valuing uncertain revenues at zero, since excessive pessimism is just as actionable as unwarranted optimism. *See In re Worlds of Wonder*, 35 F.3d at 1419; *In re Craftmatic Sec. Litig.*, 890 F.2d

628, 644 (3d Cir. 1989) ("[H]ad the omitted projections been made, we are confident that plaintiffs would have asserted that such predictions lacked a reasonable basis ....").

c. *The "risks" identified within Qwest in early 2001 also would not have significantly altered the "total mix" of information already available to the market, because the market was already largely attuned to these risks.*

This Court held in *Grossman* that "[f]orward-looking representations are ... immaterial when the defendant has provided the investing public with sufficiently specific risk disclosures or other cautionary statements concerning the subject matter of the statements at issue to nullify any potentially misleading effect." 120 F.3d at 1120. That "bespeaks caution" doctrine is a "valid defense to a securities fraud claim in the Tenth Circuit," and "cannot be ignored in construing the materiality of optimistic predictions." *Id.* at 1121. In this case, repeated cautionary statements accompanying every public projection warned investors of various risks, including adverse economic conditions and the risk that the company would not "achieve the projected synergies and financial results expected to result from the acquisition of U S West." APP-4789. For example, Qwest's April 26, 2001 filing with the SEC identified "important risk factors" such as "intense competition in the communications services market, changes in demand for Qwest's products and services, [and] dependence on new product development and acceleration of the deployment of advanced new services, such as broadband data, wireless and video services." APP-4717–18. The release's cautionary

language also directed investors to Qwest's other SEC filings, which expressly stated that Qwest recognized revenue from IRUs. *Id.*; *see* APP-4682, 2390–91, 2828–29. The April 24, 2001 release reaffirming Qwest's public projections contained virtually identical warnings.

The jury could not conclude that the warnings were inadequate. Investors knew that Qwest's projections were subject to risk. APP-1571, 1577, 1584–85, 1611–14, 1618–19, 1632–34, 1710. They also knew that Qwest's recurring revenue business had not done as well as the company had predicted. APP-3629, 3636. On April 24, 2001, Nacchio himself told analysts that the consumer and small business unit experienced slower than expected first-quarter growth, noting, "we are not pleased with the performance of that unit." APP-4807; APP-3636. Analyst Drake Johnstone wrote in his April 25, 2001 report that he "doubt[ed] the company will achieve its objective of doubling wireless subscribers from 800,000 to 1.6 million by year-end." APP-4935, 3629. (Nacchio addressed these problems by replacing the unit head. APP-4807.)

And they certainly knew that Qwest continued to sell IRUs (APP-3610–12, 3614–17, 3626, 3662, 3690–91)—a high-margin product that had formerly been the lion's share of Qwest's revenue. APP-1789–90, 2569–70. Yet the *only* "risk" to IRU revenues that Casey predicted concerned his personal assessment of the future of the economy and demand for fiber optic capacity—a risk common to the whole industry and known to investors. APP-2405, 2414, 3610–12. "[N]egligence in predicting the future economic climate ... is not actionable under the federal securities laws." *Krim*, 989 F.2d at 1449.

Moreover, the fact that subsequent disclosures had no effect on Qwest's stock price confirms that the warnings had been effective and that the information at issue was immaterial. An efficient market rapidly incorporates material information into stock prices. In this context, "the concept of materiality translates into information that alters the price of the firm's stock." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.); *see also In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 269 (3d Cir. 2005); *Shaw*, 82 F.3d at 1218; *cf. Grossman*, 120 F.3d at 1123 (plaintiffs failed to allege that there was "any impact on Novell's stock price when [the] falsity [of prior statements] was disclosed").

Qwest's subsequent disclosures had no discernible negative effect on its stock price. On August 7, 2001, Nacchio reported to investors that IRUs would likely amount to an estimated 8% of 2001 revenues. APP-4738. Over the course of August 7 and 8, Qwest's stock price declined a mere $0.09, or 0.37% (against a 1.4% decline in the S&P 500 during the same period). APP-4762, 801. In its 10-Q filed on August 14, 2001, Qwest made additional disclosures about the percentage of IRU revenues in the first and second quarters of 2001. APP-4860. In the two days of trading on August 14 and 15, Qwest shares rose by $0.58, or 2.35%. APP-4762. Similarly, on September 10, 2001, before the market opened, the company issued a press release lowering its public projections for 2001 revenues. APP-4933. That day, the stock rose $1.76, or 9.30%. APP-4763. Shortly thereafter, Qwest stock, and the broader market, began a steep decline brought on by the September 11, 2001 terrorist attacks.

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